

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO**

**SINGLE AUDIT REPORT  
Fiscal Year Ended  
June 30, 2014**

**BASIC FINANCIAL STATEMENTS AND  
SUPPLEMENTAL SCHEDULES**

**With Independent Auditors' Report Thereon  
June 30, 2014**

**Commonwealth of Puerto Rico**  
**Municipality of Aibonito**  
**Table of Contents**  
**Fiscal Year ended June 30, 2014**

Independent Auditors' Report.....	1-3
Required Supplementary Information (Part I):	
Management's Discussion and Analysis.....	4-26
Basic Financial Statements:	
Government-wide Financial Statements:	
Statement of Net Position.....	27-28
Statement of Activities.....	29
Governmental Fund Financial Statements:	
Balance Sheet – Governmental Funds.....	30
Reconciliation of the Balance Sheet –	
Governmental Funds to the Statement of Net Position.....	31
Statement of Revenues, Expenditures and	
Changes in Fund Balances – Governmental Funds.....	32
Reconciliation of the Statement of Revenues,	
Expenditures and Changes in Fund Balances –	
Governmental Funds to the Statement of Activities.....	33
Statement of Fund Net Position – Proprietary Fund.....	34
Statement of Revenues, Expenses and Changes in	
Fund Net Position – Proprietary Fund.....	35
Statement of Cash Flows – Proprietary Fund.....	36
Notes to Basic Financial Statements.....	37-82
Required Supplementary Information (Part II):	
Budgetary Comparison Schedule - General Fund.....	83
Schedule of Expenditures of Federal Awards.....	84
Notes to Schedule of Expenditures of Federal Awards.....	85
Internal Control and Compliance (Part III):	
Report on Internal Control over Financial Reporting and on	
Compliance and other matters based on an audit of Financial	
Statements performed in accordance with Government Auditing Standards.....	86-87
Report on Compliance for each major program and on	
Internal Control over compliance in accordance with OMB Circular A-133.....	88-90
Audit Findings and Questioned Costs (Part IV):	
Schedule of Findings and Questioned Costs.....	91-99
Summary Schedule of Prior Audit Findings.....	100-103



The Honorable Mayor, Members of the  
Municipal Legislature and People of  
the Municipality of Aibonito  
Aibonito, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, the business –type activities, each major fund, and the aggregate remaining fund information of the Municipality of Aibonito of the Commonwealth of Puerto Rico (the “Municipality”), as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Municipality’s basic financial statements as listed in the accompanying table of contents.

***Management’s Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

***Auditors’ Responsibility***

Our responsibility is to express opinions on these financial statements based our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

### *Opinions*

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Municipality of Aibonito of the Commonwealth of Puerto Rico, as of June 30, 2014, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, the financial statements referred to above present fairly, in all material respects, the financial position, the changes in financial position and cash flows of the business-type activities of the Municipality of Aibonito, Commonwealth of Puerto Rico, as of June 30, 2014, and the respective changes in financial position, and where applicable, cash flows thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

### *Other Matters*

#### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the Budgetary Comparison Schedule information on pages 4 through 26 and 83, respectively, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

#### *Other information*

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States and Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements.

The Schedule of Expenditures and Federal Awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditures of Federal Awards is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

***Other Reporting Required by Government Auditing Standards***

In accordance with Government Auditing Standards, we have also issued our report dated February 20, 2015, on our consideration of the Municipality of Aibonito of the Commonwealth of Puerto Rico internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards in considering the Municipality of Aibonito of the Commonwealth of Puerto Rico internal control over financial reporting and compliance.

February 20, 2015  
Toa Alta, Puerto Rico



CPA - PSC

Stamp No. O2708916  
was affixed to the  
original report.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2014

As management of the Municipality of Aibonito (the Municipality), we offer readers the following discussion and analysis of the Municipality's financial activities reported in the accompanying basic financial statements for the fiscal year ended June 30, 2014. We encourage readers to consider the information presented here in conjunction with additional information that is furnished in the Municipality's financial statements, which follow this narrative.

**FINANCIAL HIGHLIGHTS**

***Government-Wide Highlights:***

- The Municipality's assets exceeded its liabilities and deferred inflows of resources (net position) by \$36,471,223 at June 30, 2014. The Municipality's net position increased by \$1,095,438 (3% increase) during the fiscal year ended June 30, 2014.
- The Municipality's assets increased from \$55,177,610 at June 30, 2013 to \$55,875,617 at June 30, 2014, for an increase of \$698,007 (1% increase).
- The liabilities of the Municipality decreased from \$17,454,072 at June 30, 2013 to \$17,180,987 at June 30, 2014, for a decrease of \$273,085 (2% decrease).
- The deferred inflows of resources of the Municipality decreased from \$2,347,753 at June 30, 2013 to \$2,223,407 at June 30, 2014 for a decrease of \$124,346 (5% decrease).
- The revenues of the Municipality decreased from \$17,180,751 for the fiscal year ended June 30, 2013 to \$14,426,883 for the fiscal year ended June 30, 2014, for a decrease of \$2,753,868 (16% decrease).
- The Municipality's expenses decreased from \$13,666,839 for the fiscal year ended June 30, 2013 to \$13,331,445 for the fiscal year ended June 30, 2014, for a decrease of \$335,394 (2.5% decrease).
- The net position of governmental activities increased \$1,134,061 while the net position of business-type activities decreased \$38,623 for the fiscal year ended June 30, 2014.
- During the current fiscal year the Municipality completed a physical inventory and valuation of its capital assets pursuant to the provisions of GASB Statement No. 34, *Basic Financial Statements— and Management's Discussion and Analysis— for State and Local Governments*, as amended. The physical inventory and valuation resulted in a prior-period adjustment of \$12,527,582 recorded at July 1, 2013 to reduce its capital assets used in the governmental activities with a charge to net position.

***Governmental Funds Highlights:***

- The total fund balances of governmental funds amounted to \$10,882,406 at June 30, 2014, which decreased by \$697,324 during fiscal year ended June 30, 2014.
- The total assets of governmental funds decreased from \$21,949,528 at June 30, 2013 to \$18,717,294 at June 30, 2014, for a decrease of \$3,232,234 (15% decrease).
- The governmental fund's total liabilities decreased from \$8,022,045 at June 30, 2013 to \$5,550,313 at June 30, 2014, for a decrease of \$2,471,732 (31% decrease).

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2014

- The governmental fund's deferred inflows of resources decreased from \$2,347,753 at June 30, 2013 to \$2,284,575 at June 30, 2014, for a decrease of \$63,178 (3% decrease).
- The total revenues of governmental funds decreased from \$16,610,497 for the fiscal year ended June 30, 2013 to \$13,785,171 for the fiscal year ended June 30, 2014, for a decrease of \$2,825,326 (17% decrease).
- The governmental fund's total expenditures decreased from \$20,051,620 for the fiscal year ended June 30, 2013 to \$14,482,495 for the fiscal year ended June 30, 2014, for a decrease of \$5,569,125 (27.8% decrease).
- The total fund balances of governmental funds decreased \$697,324 for the fiscal year ended June 30, 2014.
- On July 1, 2013, the Municipality recorded a prior-period adjustment of \$165,140 in its Section 8 Housing Choice Voucher fund, a non-major special revenue fund, to eliminate an overstatement in deferred inflows of resources pursuant to the provisions of GASB Statement No. 33, *Accounting and Financial Reporting for Non-Exchange Transactions*. This adjustment was recorded in the accompanying governmental funds and the government-wide financial statements with charges to fund balances and net position, respectively.

***Proprietary Fund Highlights:***

- The total fund net position of the proprietary fund amounted to \$1,438,235 at June 30, 2014, which decreased by \$38,623 during fiscal year ended June 30, 2014.
- The total assets of the proprietary fund decreased from \$2,209,831 at June 30, 2013 to \$2,076,125 at June 30, 2014, for a decrease of \$133,706 (6% decrease).
- The proprietary fund's total liabilities decreased from \$732,973 at June 30, 2013 to \$637,890 at June 30, 2014, for a decrease of \$95,083 (13% decrease).
- The total revenues of the proprietary fund increased from \$570,254 for the fiscal year ended June 30, 2013 to \$580,544 for the fiscal year ended June 30, 2014, for an increase of \$10,290 (2% increase).
- The proprietary fund's total expenditures increased from \$615,864 for the fiscal year ended June 30, 2013 to \$619,167 for the fiscal year ended June 30, 2014, for an increase of \$3,303 (1% increase).

**OVERVIEW OF THE BASIC FINANCIAL STATEMENTS**

The purpose of financial reporting is to provide external users of basic financial statements with information that will help them to make decisions or draw conclusions about the Municipality. There are many external parties that use the basic financial statements of the Municipality; however, these parties do not always have the same specific objectives. In order to address the needs of as many parties as reasonably possible, the Municipality, in accordance with required financial reporting standards, presents this Management's Discussion and Analysis (MD&A) as an introduction to the accompanying basic financial statements. This narrative represents an overview and analysis of the financial activities of the

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2014

Municipality for the fiscal year ended June 30, 2014. Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage readers to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements.

The Municipality's basic financial statements include four components: (1) government-wide financial statements (GWFS), (2) governmental fund financial statements (GFFS), (3) proprietary fund financial statements (PFFS), (4) notes to the basic financial statements (NBFS). This report also contains additional required and other supplementary information in addition to the basic financial statements themselves. These components are described below.

The basic financial statements focus on: (1) the Municipality as a whole (government-wide financial reporting) and, (2) the Municipality's major individual governmental funds. Both perspectives allow the users to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability. The components of the basic financial statements are described below.

**a) *Government-wide Financial Statements***

The GWFS are composed of: (1) the statements of net position (SNP) and (2) the statement of activities (SA). These financial statements can be found immediately following this MD&A. GWFS are designed to provide readers with a broad overview of the Municipality's operations as a whole in a manner similar to private-sector business. These statements provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at June 30, 2014. The GWFS are prepared using methods that are similar to those used by most private businesses.

**1. *Statement of Net Position***

The purpose of SNP is to attempt to report all assets owned and all liabilities owed by the Municipality. The Municipality reports of all of its assets when it acquires ownership over the assets and reports all of its liabilities when they are incurred. For example, the Municipality reports buildings and infrastructure as assets, even though they are not available to pay the obligations incurred by the Municipality.

On the other hand, the Municipality reports liabilities even though these liabilities might not be paid until several fiscal years into the future.

The difference between the Municipality's total assets, total liabilities and deferred inflows of resources reported in SNP is presented as *net position*, which is similar to the total owners' equity reported by a commercial enterprise in its financial statements. Although the purpose of the Municipality is not to accumulate net position, as this amount increases or decreases over time, such amount represents a useful indicator of whether the financial position of the Municipality is either improving or deteriorating, respectively.

**2. *Statement of Activities***

The SA presents information showing how the Municipality's net position changed during the fiscal year ended June 30, 2014, by presenting all of the Municipality's revenues and expenses.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2014

As previously discussed, the items reported in SA are measured in a manner similar to the approach used by a commercial enterprise in that revenues are recognized when earned or established criteria are satisfied, and expenses are recorded when incurred by the Municipality. Consequently, revenues are reported even when they may not be collected for several months after the end of the fiscal year and expenses are recorded even though they may not have used cash during the current year.

Although SA looks different from a commercial enterprise's income statement, the difference is only in format, not substance. Whereas the bottom line in a commercial enterprise represents its net income, the Municipality reports an amount described as *net change in net position*, which is essentially the same concept.

The focus of SA is on the *net cost* of various activities provided by the Municipality. The statement begins with a column that identifies the cost of each of the Municipality's major functions. Another column identifies the revenues that are specifically related to the classified governmental functions. The difference between the expenses and revenues related to specific functions/programs identifies the extent to which each function of the Municipality draws from general revenues or is self-financing through fees, intergovernmental aid, and other sources of resources.

This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

GWFS and GFFS include all of the Municipality's governmental activities, which are supported mostly by taxes and intergovernmental revenues (such as federal and state grants and contributions). All services normally associated with the Municipality fall into this category, including culture, recreation and education; general government; health and sanitation; public safety; public housing and welfare; and economic and urban development.

**b) Governmental Fund Financial Statements**

The Municipality's GFFS consist of: (1) the balance sheet – governmental funds, and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds. These financial statements report the financial position and results of operations of the Municipality's governmental funds, with an emphasis on the Municipality's major governmental funds.

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Municipality, like most other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Each fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenue, and expenditures. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial and contractual provisions.

Governmental funds are used to account for all of the services provided by the Municipality. These funds are used to account for essentially the same functions reported as governmental activities in the GWFS. Unlike GWFS, the focus of GFFS is directed to specific activities of the Municipality rather than the Municipality as a whole; therefore, GFFS report the Municipality's operations in more detail than the GWFS.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2014

GFFS provide a detailed short-term view of the Municipality's finances that assist in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, which is, evaluating the Municipality's near-term financing requirements. For financial reporting purposes, the Municipality classifies its governmental funds within the following types: (1) general fund, (2) debt service fund, (3) special revenue funds, and (4) capital projects funds.

GFFS are prepared on an accounting basis that is significantly different from that used to prepare GWFS. In general, GFFS focus on near-term inflows and outflows of expendable financial resources, consequently, generally measure and account for cash and other assets that can easily be converted to cash. For example, amounts reported on the balance sheet include capital assets within a very short period of time, but do not include capital assets such as land and buildings. Governmental fund liabilities generally include amounts that normally are going to be paid within a very short period after the end of the fiscal year. The difference between a fund's total assets, total liabilities and deferred inflows of resources is reported as the fund balance, and generally indicates the amount that can be used to finance the next fiscal year's activities. Likewise, the operating statement for governmental funds reports only those revenues and expenditures that were collected in cash or paid with cash, respectively, during the current fiscal year or very shortly after the end of the fiscal year.

Because the focus of GFFS is narrower than that of the GWFS, it is useful to compare the fund information presented for governmental funds with similar information presented for governmental activities in the GWFS. By doing so, readers may better understand the long-term impact of the Municipality's near-term financial decisions. Both the governmental funds' balance sheet and the governmental funds' statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate the comparison between governmental funds and the governmental activities reported in the government-wide financial statements.

The Municipality has four (4) major governmental funds. Each major fund is presented in a separate column in the governmental funds' balance sheet and the governmental funds' statement of revenues, expenditures and changes in fund balances. The four (4) major governmental funds are: (1) general fund, (2) capital projects fund, (3) legislative joint resolutions fund, and (4) debt service fund.

**c) *Proprietary Fund Financial Statements***

The proprietary fund financial statements (PFFS) consist of: (1) the statement of fund net position – proprietary fund, (2) the statement of revenues, expenses and changes in fund net position – proprietary fund, and (3) the statement of cash flows – proprietary fund. These statements present the financial position, results of operations and cash flows of *Las Flores Apartments Fund* (FmHA and HUD Project No. 63-005-660-43-3572), which accounts for the leasing operations and maintenance of a residential real estate property originally acquired through the issuance of mortgage notes payable.

The activities of Las Flores Apartments have been reported in a proprietary fund in the accompanying basic financial statements, as accounting principles generally accepted in the United States of America allow the use of an enterprise fund to report any activity for which a fee is charged to external users of goods or services, regardless of whether the government intends to fully recover the cost of the goods or services provided. Thus, it is common to use proprietary fund reporting to account for services where the government intends to recover only a portion of its costs through fees

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
**Management's Discussion and Analysis**  
**Fiscal Year Ended June 30, 2014**

or user charges. Proprietary funds provide the same type of information as the GWFS, but in more detail.

*d) Notes to Basic Financial Statements*

The NBFS provide additional information that is essential for a full understanding of the data provided in the GWFS, the GFFS and PFFS. The NBFS can be found immediately following the basic financial statements.

*e) Other Supplementary Information*

The basic financial statements are followed by a section of other supplementary information consisting of: (1) Budgetary Comparison Schedule and, (2) the Schedule of expenditures of federal awards, as detailed in the accompanying table of contents.

**FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS**

The Municipality's overall financial position, for the last two fiscal years are summarized as follows, based on the information included in the accompanying GWFS:

**Comparative Statement of Net Position**  
**Governmental and Business-Type Activities (condensed)**  
**June 30, 2014 and 2013**

	<u>2014</u>	<u>2013,</u> <u>as restated</u>
<b>Assets:</b>		
Current assets	\$ 16,406,671	\$ 17,555,404
Non-current assets:		
Capital assets, net	38,946,271	37,090,026
Other non-current assets	522,675	532,180
Total assets	<u>\$ 55,875,617</u>	<u>\$ 55,177,610</u>
<b>Liabilities:</b>		
Current liabilities	\$ 2,669,175	\$ 3,085,021
Long-term obligations due within one year	1,219,906	894,359
Long-term obligations due after one year	13,291,906	13,474,692
Total liabilities	<u>17,180,987</u>	<u>17,454,072</u>
<b>Deferred inflows of resources</b>	<u>2,223,407</u>	<u>2,347,753</u>
<b>Net position:</b>		
Net investment in capital assets	30,988,335	30,515,845
Restricted for debt service, capital outlays and other purposes	5,426,579	6,998,921
Unrestricted	56,309	(2,138,981)
Total net position	<u>\$ 36,471,223</u>	<u>\$ 35,375,785</u>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
**Management's Discussion and Analysis**  
**Fiscal Year Ended June 30, 2014**

At June 30, 2014, the Municipality's assets, amounting to \$55,875,617, are mainly composed of capital assets, net of accumulated depreciation (\$38,946,271) and cash in commercial banks and fiscal agent (\$12,296,323). As previously mentioned, the total assets of the Municipality increased \$698,007 (1% increase) in comparison with the prior fiscal year.

Capital assets increased by \$1,856,245 due to the excess of current year additions (\$3,236,172) over depreciation expense (\$1,379,927) for the fiscal year ended June 30, 2014. The principal additions to capital assets for the current fiscal year were related to buildings, structures, and improvements (\$2,852,032), infrastructure (\$285,389), and machinery and equipment, and furniture and fixtures (\$98,751).

The cash balances include restricted cash of \$10,524,822 which is legally designated for: (1) the payment of debt service, (2) the acquisition, construction and improvement of major capital assets, and (3) the operations of federally and state funded grant award programs. Total cash balances decreased \$2,473,489 (17% decrease) principally due to the effect of significant disbursements made related to the decrease in bonds payable (\$533,500), the decrease in accounts payables and accrued liabilities (\$277,876), the decrease in intergovernmental payables (\$151,156), and the decrease in notes payable (\$99,935). The decrease is also related to the current year capital outlays referred to above amounting to \$3,236,172, which were partially offset by the current year excess of revenues over expenses of \$1,095,438.

At June 30, 2014, the Municipality's liabilities amounting to \$17,180,987 are mainly composed of bonds payable (\$12,316,110), accrued compensated absences (\$1,482,546), accounts payable and accrued liabilities (\$1,203,338) and intergovernmental payables (\$1,173,048).

As previously mentioned, the total liabilities of the Municipality decreased \$273,085 (2% decrease) in comparison with the prior fiscal year. Such decrease is related to the decrease in bonds payable (\$533,500), the decrease in accounts payables and accrued liabilities (\$277,876), the decrease in intergovernmental payables (\$151,156), and the decrease in notes payable (\$99,935).

The decreases in bonds and notes payable of \$533,500 and \$99,935, respectively, are due to the current year debt service payments made, while no new debt issuances were made during the current fiscal year. The decreases in accounts payable and accrued liabilities and intergovernmental payables of \$277,876 and \$151,156, respectively, are due to the Municipality's new policy of minimizing the outstanding days in its current liabilities accelerating their payments as the positive cash flows from operations allow it.

Deferred inflows of resources consist mainly of revenues collected in advance associated with municipal license taxes (\$1,468,544) and intergovernmental grants and contributions related to state and federally funded programs (\$754,863). The total deferred inflows of resources decreased only \$124,346 (5% decrease) in comparison with the prior fiscal year, which was expected as collections in advance of municipal license taxes remained fairly online with the prior fiscal year's collections.

As noted earlier, net position may serve over time as a useful indicator of the Municipality's financial statement position. The assets of the Municipality exceeded liabilities and deferred inflows of resources by \$36,471,223 at June 30, 2014. The most significant portion of net position (\$30,988,335) reflects the Municipality's investment in capital assets (e.g. land, buildings, machinery, equipment, infrastructure, etc.), net of all related debt still outstanding that was issued to acquire, construct or improve those assets. The Municipality uses its capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although the Municipality's investment in capital assets is reported net of the outstanding related debt, the resources needed to repay that debt must be provided by other

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
**Management's Discussion and Analysis**  
**Fiscal Year Ended June 30, 2014**

sources, as capital assets cannot be used to liquidate these liabilities. Another significant portion of net position at June 30, 2014, represents resources that are restricted for debt service payments (\$2,711,737) and the operations of state and federally funded grant award programs and capital projects (\$2,714,842). The remaining component of total net position consists of unrestricted balance of \$56,309 at June 30, 2014. The total net position of the Municipality increased by \$1,095,438 for the fiscal year ended June 30, 2014, which is explained in the following section of this discussion and analysis.

The following is a comparative condensed presentation of the Municipality's results of operations as reported in the GWFS:

**Comparative Statement of Activities**  
**Governmental and Business-Type Activities (condensed)**  
**Fiscal Years Ended June 30, 2014 and 2013**

	2014	2013
<b>Program revenues:</b>		
Program-specific operating grants and contributions	\$ 1,952,011	\$ 3,466,149
Program-specific capital grants and contributions	571,768	2,423,404
Charges for services	86,377	69,211
Total program revenues	2,610,156	5,958,764
<b>General revenues:</b>		
Property taxes	2,425,225	2,467,012
Municipal license taxes	1,918,314	1,661,426
Construction excise taxes	404,867	245,498
Sales and use tax	641,305	618,564
Unrestricted grants and contributions	5,735,027	4,303,638
Interests on deposits and miscellaneous revenues	691,989	1,925,849
Total general revenues	11,816,727	11,221,987
Total revenues	14,426,883	17,180,751
<b>Program expenses:</b>		
General government	4,512,776	4,644,930
Urban and economic development	4,254,460	5,031,822
Health and sanitation	420,333	616,523
Public safety	217,079	124,930
Public housing and welfare	1,789,308	1,507,884
Culture, recreation and education	1,513,675	1,170,880
Interests on bonds and notes payable	623,814	569,870
Total expenses	13,331,445	13,666,839
<b>Net increase in net position</b>	1,095,438	3,513,912
<b>Net position, at beginning of fiscal year</b>	47,738,227	44,224,315
<b>Prior period adjustments</b>	(12,362,442)	-
<b>Net position, at beginning of fiscal year, as restated</b>	35,375,785	44,224,315
<b>Net position, at end of fiscal year</b>	\$ 36,471,223	\$ 47,738,227

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2014

As previously mentioned, the Municipality's net position increased by \$1,095,438 during the current fiscal year, which is due to the excess of revenues over expenses during the current fiscal year.

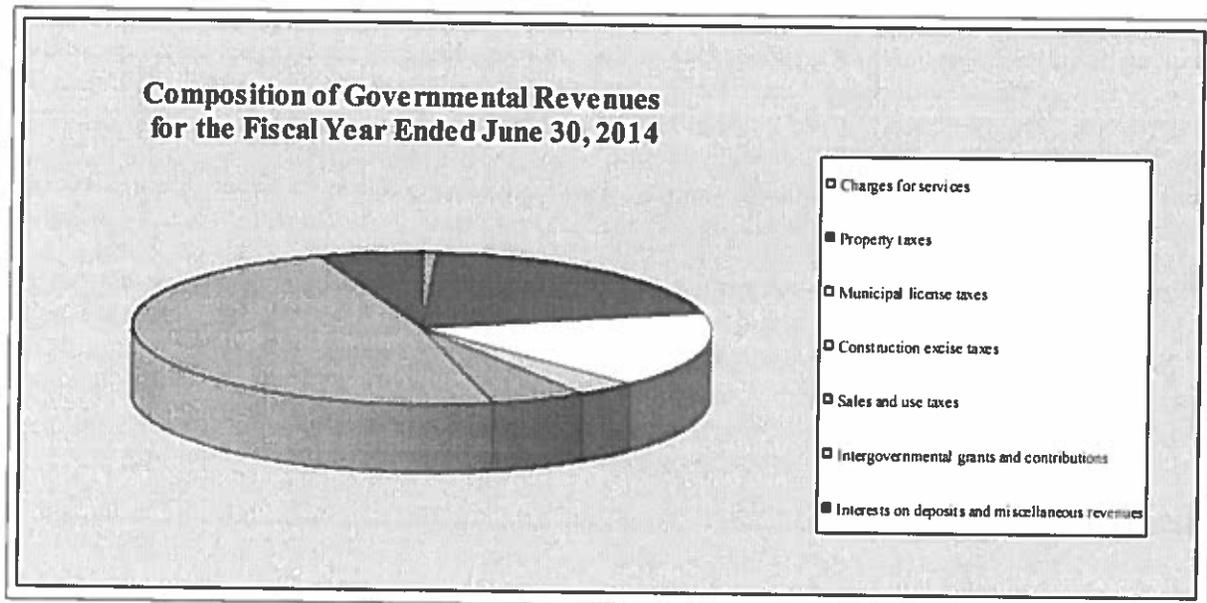
The net change in net position decreased from \$3,513,912 in 2013 to \$1,095,438 in 2014. Such fluctuation is due to the decrease of \$2,753,868 (16% decrease) in total revenues and the decrease of \$335,394 (2% decrease) in total expenses.

The total revenues of the Municipality amounted to \$14,426,883 for the current fiscal year. The most significant of those revenues consist of intergovernmental grants and contributions (\$8,258,806) and tax revenues (\$5,389,711), which account for 57% and 37% of total revenues, respectively.

Intergovernmental grants and contributions revenues decreased \$1,934,385 (19% decrease) principally due to the decrease of \$1,311,000 in program-specific capital grants and contributions previously awarded by the Legislature of the Commonwealth of Puerto Rico. Those grants are discretionary in nature and are subject to budgetary appropriations made by the Legislature of the Commonwealth of Puerto Rico, which were significantly reduced in connection with actual cash flows shortfalls and the budgetary deficit of the Commonwealth of Puerto Rico. During the prior fiscal year, the Municipality received \$1,311,000 in grants from the legislative branch referred to above while in the current fiscal year no grants were awarded.

Tax revenues increased \$397,211 (8% increase) in comparison with the prior fiscal year principally due increases in municipal license taxes of \$256,888 (15% increase) and construction excise taxes of \$159,369 (65% increase). Those two individual increases are related to the taxes paid by a new american retail store that made its construction in Aibonito and started operations in the current fiscal year. In addition, during the current fiscal year there was an increased number of municipal construction projects, including the baseball stadium project, which were carried out during the current fiscal year and provided significant additional tax revenues.

Interests and miscellaneous revenues decreased \$1,233,860 in comparison with the prior fiscal year is due to a non-recurrent one-time collection made in the prior fiscal year related to a portion of the allocation of the state sales and use taxes applicable to internet sales that were distributed to the Municipalities of Puerto Rico in the prior fiscal year.



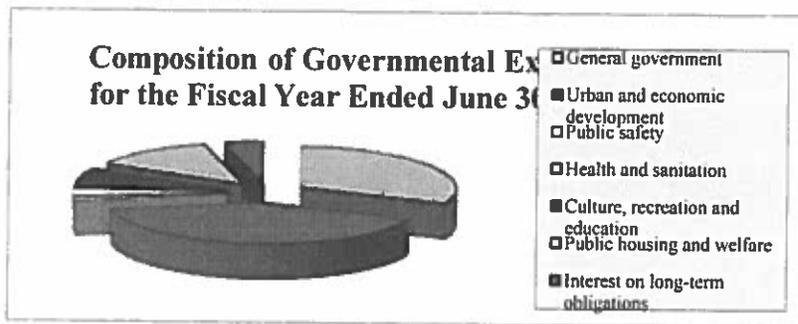
**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
**Management's Discussion and Analysis**  
**Fiscal Year Ended June 30, 2014**

The Municipality's expenses cover a wide range of services. The largest expenses of the Municipality for the fiscal year ended June 30, 2014 were related to: (1) general administrating and operating costs (\$4,512,776), which were classified as "general government", (2) urban and economic development (\$4,254,460), (3) culture, recreation and education (\$1,513,675) and (4) public housing and welfare (\$1,789,308).

As previously mentioned, the Municipality's expenses decreased from \$13,666,839 for the fiscal year ended June 30, 2013 to \$13,331,445 for the fiscal year ended June 30, 2014. The most significant fluctuations between the current fiscal year's expenses and those of the prior fiscal year occurred in urban and economic development expenses, which decreased \$777,362 (15% decrease). On the other hand, culture, recreation and education expenses, and public housing and welfare expenses increased \$342,795 and \$281,424, respectively, in connection with management's strategic plan and projects carried out in these areas during the current fiscal year. More emphasis was made during the current fiscal year in projects related to these two functions while in the previous fiscal year the Municipality used a much higher amount of resources in urban development projects, including the repairs and maintenance of infrastructure and buildings.

For day-to-day purposes, the Municipality maintained a strict budgetary control over expenses during the current fiscal year. Expenses and cash flows were closely monitored on a daily basis, therefore, the overall decrease in total expenses was only \$335,394 (2% decrease).

The following chart presents the composition of expenses for the fiscal year ended June 30, 2014:



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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
**Management's Discussion and Analysis**  
**Fiscal Year Ended June 30, 2014**

**Condensed Balance Sheet - Governmental Funds**  
**June 30, 2014 and 2013**

<b>Assets:</b>	<u>2014</u>	<u>2013,</u> <u>as restated</u>
Total assets - major governmental funds	\$ 15,578,025	\$ 18,839,571
Total assets - other governmental funds	3,139,269	3,109,957
Combined assets	<u>\$ 18,717,294</u>	<u>\$ 21,949,528</u>
 <b>Liabilities:</b>		
Total liabilities - major governmental funds	\$ 5,376,598	\$ 7,890,275
Total liabilities - other governmental funds	173,715	131,770
Combined liabilities	<u>5,550,313</u>	<u>8,022,045</u>
 <b>Deferred inflows of resources</b>	<u>2,284,575</u>	<u>2,512,893</u>
 <b>Fund balances:</b>		
Assigned - general fund	578,228	175,766
Restricted - other major governmental funds	6,863,776	8,653,524
Restricted - other governmental funds	2,211,560	2,058,766
Unassigned - general fund	1,228,842	526,534
Combined fund balances	<u>10,882,406</u>	<u>11,414,590</u>
 <b>Total liabilities, deferred inflows of resources, and fund balances</b>	 <u>\$ 18,717,294</u>	 <u>\$ 21,949,528</u>

**FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS**  
*Analysis of Financial Position of Governmental Funds*

As discussed earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows, and balances of expendable resources. Such information is useful in assessing the Municipality's compliance with finance-related legal requirements. Specifically, unreserved fund balance may serve as a useful measure of the Municipality's net resources available for spending at the end of the fiscal year.

At June 30, 2014, the total assets of governmental funds decreased by \$3,232,234 (15% decrease) in comparison with the prior fiscal year, principally for the decrease of \$2,473,489 in cash in commercial banks and fiscal agent and the decrease of \$2,055,821 in receivables among governmental funds. These decreases were partially offset with an increase of \$1,277,468 in intergovernmental grants and contributions receivable.

The decrease in cash balances of \$2,473,489 (17% decrease) is principally due to the effect of significant disbursements made related to the decrease in accounts payables and accrued liabilities (\$562,544), the

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
**Management's Discussion and Analysis**  
**Fiscal Year Ended June 30, 2014**

decrease in intergovernmental payables (\$151,156), and the decrease in notes payable (\$99,935). The decrease is also related to the current year capital outlays referred to above amounting to \$3,236,172.

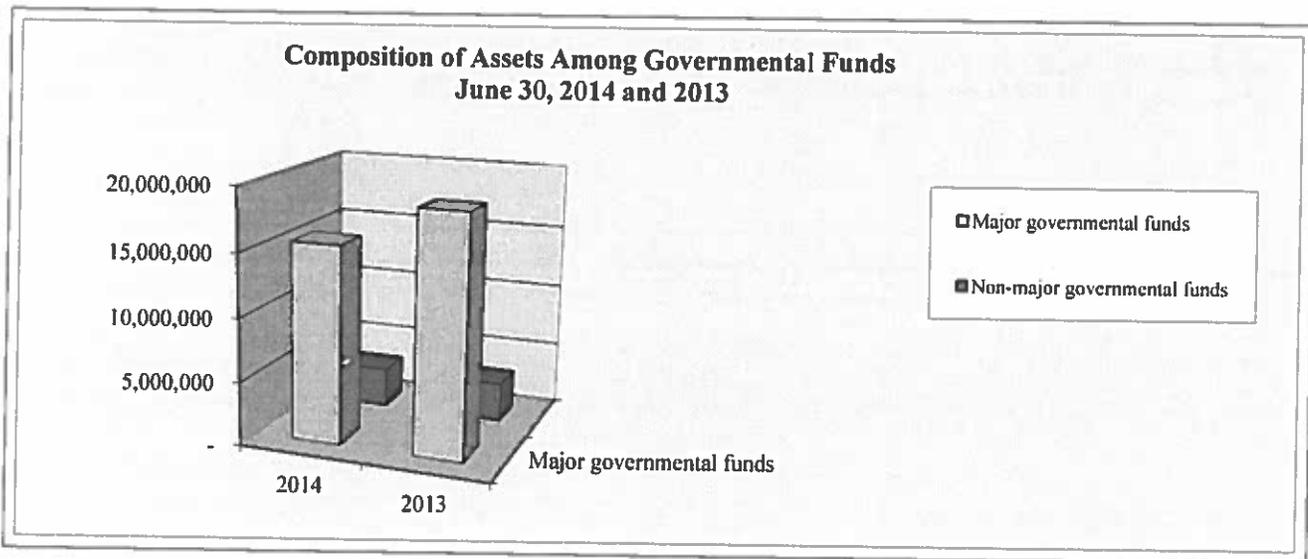
The decrease of \$2,055,821 in receivables among governmental funds is related to increased collection efforts made pursuant to an analysis and reconciliation during the current fiscal year of its interfund balances previously outstanding for several years.

The increase in intergovernmental grants and contributions receivable of \$1,277,468 is mainly related to the grants due from the Special Communities Trust Fund of the Commonwealth of Puerto Rico amounting to \$1,151,679 which are related to construction projects completed in previous years and management is currently pursuing the collection of such amounts from the Commonwealth of Puerto Rico.

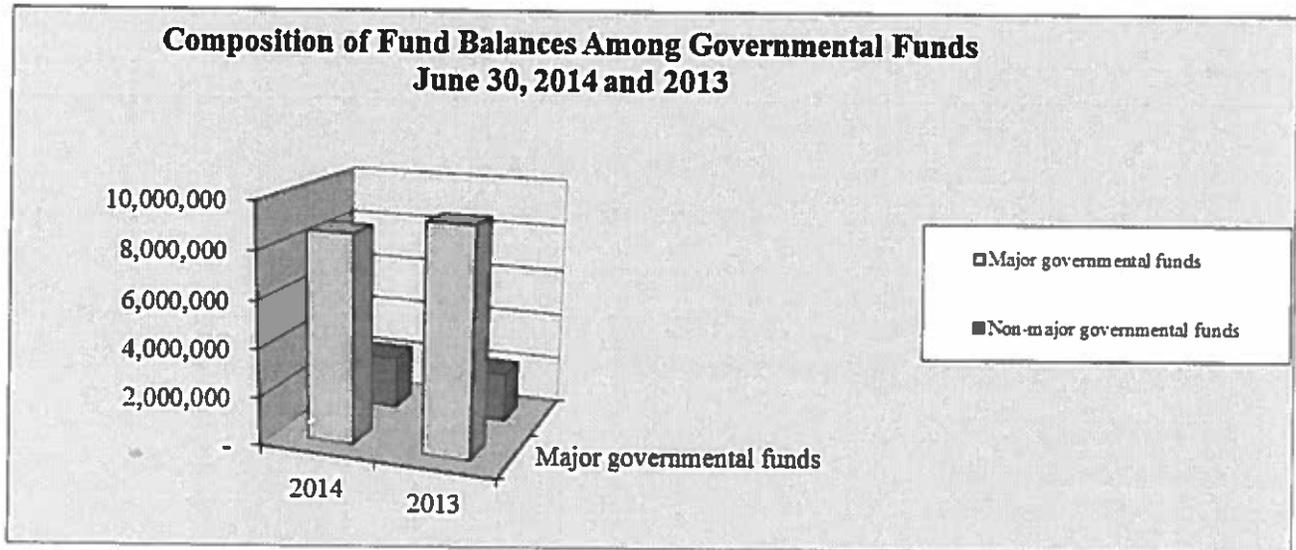
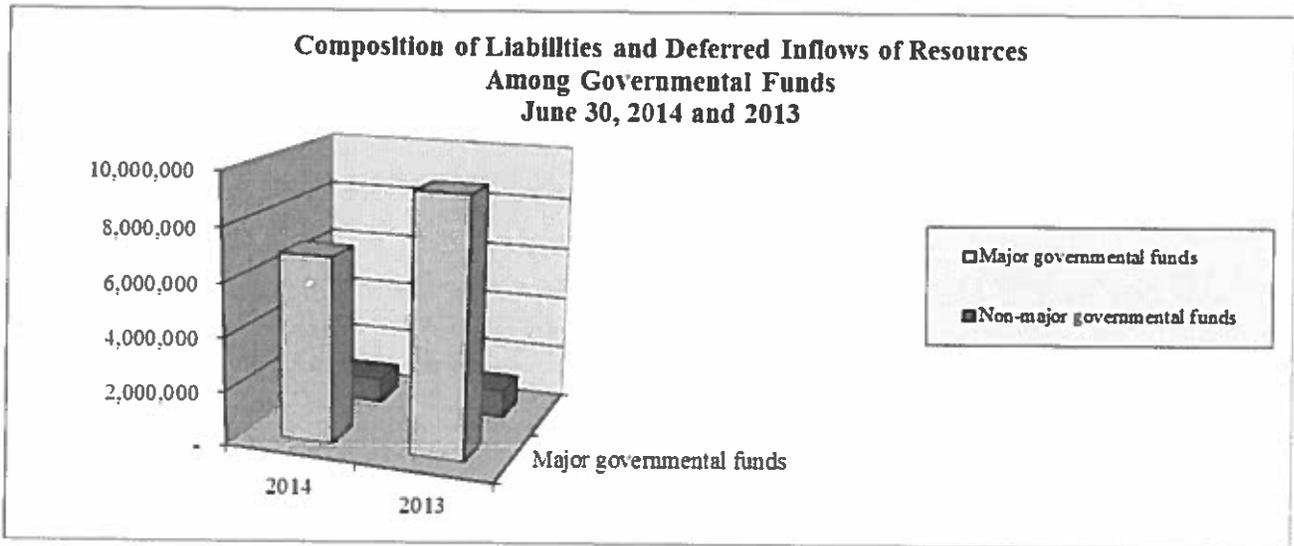
At June 30, 2014, the total liabilities of governmental funds decreased by \$2,471,732 (31% decrease in comparison with the prior fiscal year. Such decrease is related to the decrease in accounts payables and accrued liabilities (\$562,544), the decrease in intergovernmental payables (\$151,156), and the decrease in payables among governmental funds (\$2,055,821) for the reasons referred to above.

Deferred inflows of resources consist mainly of revenues collected in advance associated with municipal license taxes and intergovernmental grants and contributions related to state and federally funded programs. The total deferred inflows of resources decreased only \$228,318 (9% decrease) in comparison with the prior fiscal year, which was expected as collections in advance of municipal license taxes remained fairly online with the prior fiscal year's collections.

At the end of the current fiscal year, total unassigned fund balances of governmental funds amounted to \$1,228,842, while total fund balances reached \$10,882,406. The total fund balances decreased by \$697,324 during the current fiscal year. The following tables present the composition of assets, liabilities and fund balances among governmental funds at June 30, 2014 and 2013:



COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2014



For a detailed explanation of the individual fluctuations of total assets and total liabilities of governmental funds, please refer to the previous financial analysis of the government-wide financial statements included in this management's discussion and analysis, where a detailed discussion of most of these fluctuations has been made. In addition, a detailed analysis of the current fiscal year activity of the individual major governmental funds is presented as follows:

**General fund (GF)** - The GF is the main operating fund used to account for all financial resources and governmental activities, except for financial resources required to be accounted for in another fund due to legal requirements, GAAP requirements or the demands of sound financial administration requiring the use of a governmental fund other than the general fund.

The GF's total assets amounted to \$5,738,884 at June 30, 2014. Such assets consist principally of: (1) cash in commercial banks and fiscal agent (\$1,771,501), (2) intergovernmental grants and contributions receivable (\$1,195,856), and (3) tax receivables (\$1,171,353).

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2014

Total assets decreased \$936,910 (14% decrease) in comparison with the prior fiscal year. Such decrease is principally related to the decrease in cash in commercial banks and fiscal agent of \$797,223 (31% decrease) and the decrease in amounts due from other governmental funds of \$154,376 (9% decrease).

The decrease in cash in commercial banks and fiscal agent is related to significant disbursements made during the current fiscal year as a management's policy to minimize the outstanding balances of current liabilities in situations when idle cash balances exceed the amounts needed for the routine operations of the Municipality. Those significant disbursements resulted in a decrease in amounts due to other governmental funds of \$1,900,733 (70% decrease), a decrease in intergovernmental payables of \$151,156 (11% decrease), and an increase in accounts payable and accrued liabilities of \$73,969 (23% increase). These decreases were partially offset by the current fiscal year net change in fund balances of \$1,104,770.

The GF's total liabilities amounted to \$2,402,102 at June 30, 2014. Such liabilities are composed of: (1) intergovernmental payables (\$1,173,048), (2) accounts payable and accrued liabilities (\$401,749), and due to other funds (\$827,305).

The decrease in total liabilities of \$1,977,920 (45% decrease) is principally related to the decrease of the decrease of \$1,900,733 in amounts due to other governmental funds, the decrease in intergovernmental payables, and the decrease in accounts payable and accrued liabilities for the reasons and amounts referred to above.

At the end of the current fiscal year, unassigned fund balance of the GF's amounted to \$1,228,842, while total fund balance reached \$1,807,070. As a measure of the GF's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unassigned fund balance represents 12 percent of the total GF's expenditures, while total fund balance represents 18 percent of that same amount. The increase of \$1,104,770 in total fund balances is strictly related to the current year excess of revenues over expenditures and other sources, net.

**Capital improvements bond fund (CIBF)** – The CIBF is a major capital projects fund used to account for the financial resources arising principally from bond issuance proceeds and intergovernmental grants and contributions used in the acquisition or construction of major capital facilities, other assets, and permanent improvements. The CIBF's total assets amounted to \$5,035,375 at June 30, 2014, which consists mainly of restricted cash in fiscal agent (unspent bond proceeds of \$4,641,707). The CIBF's total liabilities and deferred inflows of resources amounted to \$2,197,536 at June 30, 2014, which are mainly composed of: (1) accounts payable and accrued liabilities (\$692,794), and (2) amounts due to other funds (\$1,503,873).

The total assets of the CIBF decreased \$1,970,474 (28% decrease) due to the decrease in cash in fiscal agent of \$2,021,990 that resulted from the current year capital outlays of \$1,837,174.

The total liabilities of the CIBF decreased \$418,100 (16% decrease) due to the decrease of \$224,129 in amounts due to other governmental funds and the decrease of \$193,971 in accounts payable and accrued liabilities that resulted from significant disbursements made during the current fiscal year as a management's policy to minimize the outstanding balances of current liabilities in situations when idle cash balances exceed the amounts needed for the routine operations of the CIBF.

At the end of the current fiscal year, CIBF's total and restricted fund balance reached \$2,837,839. Such fund balance decreased \$1,553,243 due the deficiency of revenues under expenditures and other financing uses, net.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2014

**Legislative joint resolutions fund (LJRF)** - The LJRF is a major capital projects fund used to account for the financial resources arising from program-specific capital grants and contributions awarded by the Legislature of the Commonwealth of Puerto Rico, which are principally used in the acquisition or construction of major capital facilities, other assets and permanent improvements. The LJRF's total assets amounted to \$1,314,200 at June 30, 2014, which consist of restricted cash in commercial banks (unspent grant awards and contributions) from the Legislature of the Commonwealth of Puerto Rico amounting to \$487,397 and the amount of \$826,803 due from other governmental funds.

The total assets of the LJRF decreased \$756,665 (37% decrease) mainly due to the decrease of \$754,644 in cash in commercial banks that resulted from the current year capital outlays amounting to \$627,338 and the decrease of \$135,846 in accounts payable and accrued liabilities. Such decrease in liabilities is due to the current year management's policy to minimize the outstanding balances of current liabilities in situations when idle cash balances exceed the amounts needed for the routine operations of the CIBF.

At the end of the current fiscal year, LJRF's total and restricted fund balance reached \$1,314,200. Such fund balance decreased \$620,819 due to the deficiency of revenues under capital outlays.

**Debt service fund (DSF)** - The DSF is a major fund used to account for the accumulation of resources for, and the payment of, principal and interest for bonds and notes payable. The DSF's total assets amounted to \$3,489,566 at June 30, 2014, which consists mainly of restricted cash in fiscal agent (\$3,269,462) and intergovernmental grants and contributions receivable (\$214,548). The DSF's total liabilities amounted to \$777,829 at June 30, 2014, which are mainly composed of: (1) matured bonds due and payable (\$485,000) and (2) accounts payable and accrued liabilities (\$292,789).

The total assets of the DSF increased \$402,503 (13% increase) mainly due to the increase of \$139,518 in intergovernmental grants and contributions received from the Puerto Rico Treasury Department, and the increase of \$263,610 in cash in fiscal agent.

The increase in the intergovernmental grants and contributions receivable is related to the increase in collections made by the Commonwealth of Puerto Rico of the portion of the state sales and use taxes corresponding to the month of June 2014 that were distributed to the Municipalities as a contribution.

The increase in cash in fiscal agent is mainly due to the increase of \$142,323 (36% increase) in property tax collections made by the Municipal Revenue Collection Center as part of additional efforts made to minimize the outstanding property tax receivables during the current fiscal year.

The total liabilities of the DSF remained fairly on-line with the prior fiscal year because the matured bonds and matured interests due and payable decreased only \$18,186.

At the end of the current fiscal year, DSF's total and restricted fund balance reached \$2,711,737. Such fund balance increased \$384,314 due to the excess of revenues over expenditures and other financing uses, net.

**Other governmental funds (OGF)** - The OGF's is a non-major major special revenue funds principally used to account for the financial resources arising from program-specific operating grants and contributions awarded by state and federal agencies. The OGF's total assets amounted to \$3,139,269 at June 30, 2014, which consist mainly of restricted cash in commercial banks and fiscal agent (\$1,849,793). The OGF's total liabilities and deferred inflows of resources amounted to \$927,709 at June 30, 2014,

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
**Management's Discussion and Analysis**  
**Fiscal Year Ended June 30, 2014**

which are mainly composed of unearned grant revenues (\$753,994), accounts payable and accrued liabilities (\$77,454), and amounts due to other funds (\$96,261).

The cash in commercial banks and fiscal agent of OGF increased \$744,737 principally due to the reduction of \$1,901,445 in amounts due from the general fund that resulted from increased collections.

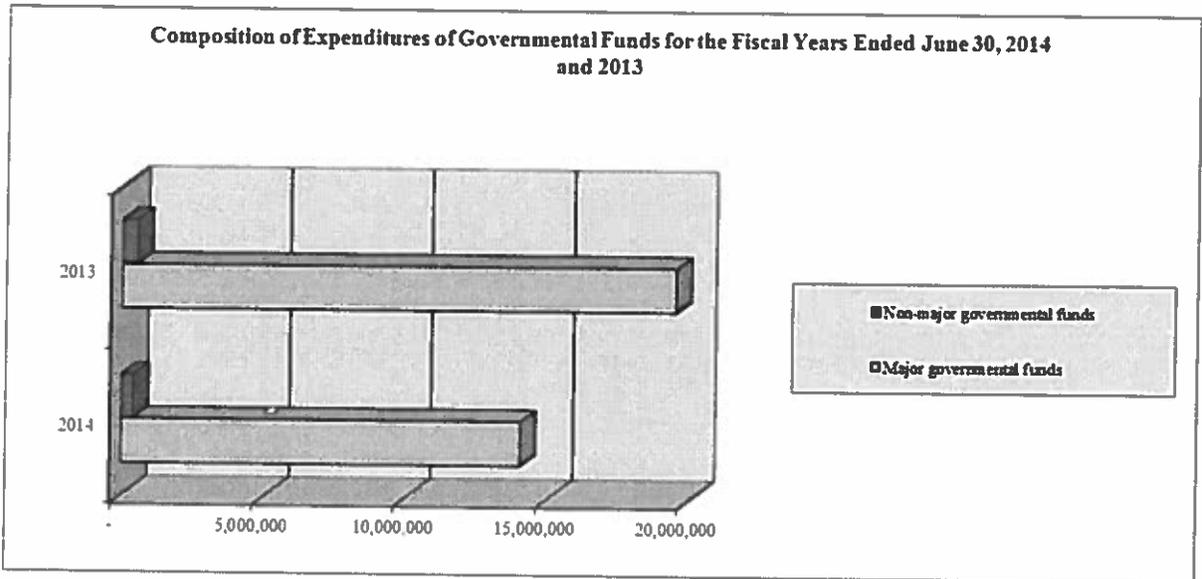
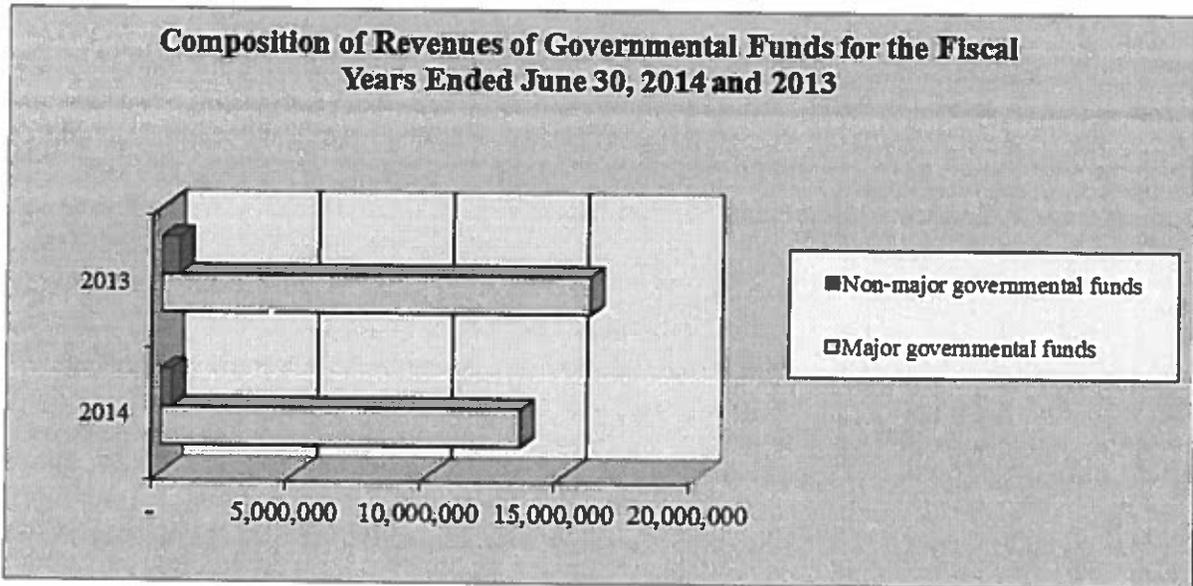
The total liabilities of the OGF remained fairly on-line with the prior fiscal year. A slight increase of \$41,945 (32% increase) occurred principally caused by an increase in accounts payable and accrued liabilities.

**Condensed Statement of Revenues, Expenditures and  
Changes in Fund Balance -Governmental Funds  
Fiscal Years Ended June 30, 2014 and 2013**

<b>Revenues:</b>	<u>2014</u>	<u>2013</u>
Total revenues - major governmental funds	\$ 13,376,066	\$ 15,930,399
Total revenues - other governmental funds	409,105	680,098
Combined total revenues	<u>13,785,171</u>	<u>16,610,497</u>
 <b>Expenditures:</b>		
Total expenditures - major governmental funds	14,061,484	19,509,348
Total expenditures - other governmental funds	421,011	542,272
Combined total expenditures	<u>14,482,495</u>	<u>20,051,620</u>
 <b>Deficiency of revenues under expenditures</b>	<u>(697,324)</u>	<u>(3,441,123)</u>
 <b>Other financing sources (uses), net:</b>		
Proceeds from issuance of bonds	-	1,535,000
Other financing sources, net - major governmental funds	318,614	482,190
Other financing uses, net - other governmental funds	<u>(318,614)</u>	<u>(482,190)</u>
Combined other financing sources, net	<u>-</u>	<u>1,535,000</u>
 <b>Deficiency of revenues and other financing sources under expenditures and other financing uses</b>	<u>(697,324)</u>	<u>(1,906,123)</u>
 <b>Fund balances, at beginning of fiscal year</b>	11,414,590	13,320,713
<b>Prior period adjustments</b>	165,140	-
<b>Fund balances, at beginning of fiscal year, as restated</b>	<u>11,579,730</u>	<u>13,320,713</u>
<b>Fund balances, at end of fiscal year</b>	<u>\$ 10,882,406</u>	<u>\$ 11,414,590</u>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2014

**Analysis of Operating Results of Governmental Funds**



The following is a detailed analysis of the results of operations of governmental funds for the fiscal year ended June 30, 2014:

**General fund (GF)** – The total fund balance of the GF increased \$1,104,770 during current fiscal year. Total revenues, expenditures and other financing sources (net) amounted to \$11,100,046, \$10,186,445 and \$191,169, respectively, for the fiscal year ended June 30, 2014.

Approximately 44 percent (\$4,851,803) of the GF's total revenues for the current fiscal year came from taxes (property taxes, municipal license taxes, construction excise taxes and sales and use taxes), while 51 percent (\$5,673,859) resulted from intergovernmental grants and contributions.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2014

During the current fiscal year, there was an excess of revenues and other financing sources over expenditures and other financing uses of \$1,104,770, while in the prior fiscal there was an excess of revenues and other financing sources over expenditures and other financing uses of \$20,425.

The total revenues of the GF increased only \$547,375 (5% increase) in comparison with the prior fiscal year. Such increase is related to the increase of \$1,370,221 in intergovernmental grants and contributions, the increase of \$254,888 in tax revenues, the decrease of \$950,946 in miscellaneous revenues and the decrease of \$143,790 in interests on deposits.

The increase in intergovernmental grants and contributions is mainly related to an increase in the contribution in lieu of taxes from the Puerto Rico Electric Power Authority and other contributions from the Commonwealth of Puerto Rico, including the subsidy for the Christmas bonuses paid to employees in the current fiscal year.

The decrease in interest income is related to the decrease of \$797,223 in cash in commercial banks and the decrease in the interest yield earned in comparison with the prior fiscal year.

The decrease in miscellaneous revenues is due to a non-recurrent one-time collection made in the prior fiscal year related to a portion of the allocation of the state sales and use taxes applicable to internet sales that were distributed to the Municipalities of Puerto Rico in the prior fiscal year.

The total expenditures of the GF decreased \$653,159 (6% decrease). The most significant fluctuations between the current fiscal year's expenses and those of the prior fiscal year occurred in: (1) general government expenditures, which decreased \$579,209 (12% decrease), (2) urban and economic development expenditures, which increased \$389,906 (12% increase), (3) culture, recreation and education expenditures, which decreased \$360,239 (29% decrease), and (4) health and sanitation expenditures, which decreased \$225,951 (37% decrease).

On the other hand, urban and economic development expenditures increased \$389,906 and public housing and welfare expenditures increased \$185,374 in connection with management's strategic plan and projects carried out in these areas during the current fiscal year. More emphasis was made during the current fiscal year in projects related to these two functions while in the previous fiscal year the Municipality used a much higher amount of resources in other functions.

For day-to-day purposes, the Municipality maintained a strict budgetary control over GF's expenditures during the current fiscal year. Expenditures and cash flows were closely monitored on a daily basis, therefore, the overall decrease in total expenses was experienced.

**Capital improvements bond fund (CIBF)** – The most significant transactions of this fund for the current fiscal year are related to capital outlays (\$1,837,174) and interests on deposits (\$190,432). The total fund balance of the CPF decreased \$1,553,243 during current fiscal year. Total revenues, expenditures and other financing uses (net) amounted to \$762,200, \$2,125,305 and \$190,138, respectively, for the fiscal year ended June 30, 2014.

The total revenues of the CIBF decreased \$1,972,590 (72% decrease) mainly due to the decrease of \$1,851,636 in intergovernmental grants and contributions from the Commonwealth of Puerto Rico. Those grants are discretionary in nature and are subject to budgetary appropriations made by the

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2014

Commonwealth of Puerto Rico, which were significantly reduced in connection with actual cash flows shortfalls and the budgetary deficit of the Commonwealth of Puerto Rico.

The total expenditures of the CIBF decreased \$4,472,323 (68% decrease) principally due to the decrease of \$4,420,874 in capital outlays. The decrease in capital outlays is the result of the decrease in intergovernmental grants and contributions referred to above and the lack of bond issuance proceeds in the current fiscal year while in the previous fiscal year amounted to \$1,535,000.

**Legislative joint resolutions fund (LJRF)** – The most significant transactions of this fund for the current fiscal year are related to capital outlays (\$627,338). Total revenues and expenditures amounted to \$6,519 and \$627,338, respectively, for the fiscal year ended June 30, 2014. The total fund balance of LJRF decreased \$620,819.

The total revenues of the LJRF decreased \$1,324,012 (99% decrease) mainly due to the decrease of \$1,311,000 in intergovernmental grants and contributions from the Legislature of the Commonwealth of Puerto Rico. Those grants are discretionary in nature and are subject to budgetary appropriations made by the Legislature of the Commonwealth of Puerto Rico, which were significantly reduced in connection with actual cash flows shortfalls and the budgetary deficit of the Commonwealth of Puerto Rico.

The total expenditures of the LJRF decreased \$344,608 (35% decrease) principally due to the decrease in capital outlays. The decrease in capital outlays is the result of the decrease in intergovernmental grants and contributions referred to above.

**Debt service fund (DSF)** – The total fund balance of the DSF increased \$384,314 during current fiscal year. Total revenues, expenditures and other financing uses (net) amounted to \$1,507,301, \$1,122,396 and \$591, respectively, for the fiscal year ended June 30, 2014. Approximately 36 percent (\$537,908) of DSF's total revenues for the current fiscal year came from restricted property taxes, while 64 percent (\$966,655) came from intergovernmental grants and contributions.

The total revenues of the DSF increased \$194,894 (15% increase) due to increases in property tax revenues and intergovernmental grants and contributions of \$142,323 and \$52,410, respectively.

The increase in property tax revenues is due additional efforts made by the Municipal Revenue Collection Center to maximize the property tax collections during the current fiscal year.

The increase in the intergovernmental grants and contributions is related to the increase in collections made by the Commonwealth of Puerto Rico of the portion of the state sales and use taxes that were distributed to the Municipalities as a contribution during 2014, which remained fairly online with the prior fiscal year.

All expenditures of the debt service fund were related to principal and interest expenditures on bonds and notes payable amounting to \$1,122,396 during the current fiscal year. Only a slight increase of \$22,226 was experienced as expected.

**Other governmental funds (OGF)** – The total fund balance of the OGF decreased by \$12,346 during current fiscal year. Total revenues, expenditures and other financing uses (net) amounted to \$409,105, \$421,011 and \$440, respectively, for the fiscal year ended June 30, 2014.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
**Management's Discussion and Analysis**  
**Fiscal Year Ended June 30, 2014**

One hundred percent (\$408,306) of OGF's total revenues for the current fiscal year came from intergovernmental grants and contributions. Approximately 13 percent (\$56,335) of OGF's total expenditures for the current fiscal year came from general government and 87 percent (\$364,676) from public housing and welfare.

**FINANCIAL ANALYSIS OF PROPRIETARY FUND BUSINESS-TYPE ACTIVITIES**

The proprietary fund (PF) accounts for the leasing operations and maintenance of a residential real estate property originally acquired through the issuance of mortgage notes payable.

The capital assets of the PF, amounting to \$1,466,286, represent 71% of its total assets. Such assets are composed principally of buildings and structures. During the current fiscal year such capital assets decreased \$153,666 due to the net effect of depreciation expense (\$211,205) and the current year acquisitions of equipment and other capital assets (\$57,539).

The total liabilities of the PF amounted to \$637,890, of which \$587,792 (92% of total liabilities) represents the outstanding balance of mortgage notes payable. The decrease in total liabilities is principally due to the decrease of \$99,935 in mortgage notes payable caused by the current year debt service payments made.

During the current fiscal year, the PF suffered a net decrease in fund net position of \$38,623. As in prior fiscal years, the net operating loss of \$575,755 is partially offset by non-operating revenues, principally related to intergovernmental grants and contributions not specifically restricted to capital purposes (\$577,050), which are awarded by the U.S. Department of Housing and Urban Development.

**BUDGETARY HIGHLIGHTS OF GENERAL FUND**

The original and final budget of the general fund for the fiscal year ended June 30, 2014 amounted to \$10,008,019 and \$10,471,020, respectively. The increase of \$463,001 (5% increase) is principally due to anticipated increases in sales and use taxes and municipal licenses taxes throughout the current fiscal year.

The total actual revenues (budgetary basis) of the general fund for the fiscal year ended June 30, 2014 were \$11,085,084 which is 6 percent (\$614,064) more than the final budgeted revenues. In addition, the total actual expenditures (budgetary basis) of the general fund for the fiscal year ended June 30, 2014 were \$9,982,677, which is 5 percent (\$488,343) less than the final budgeted expenditures.

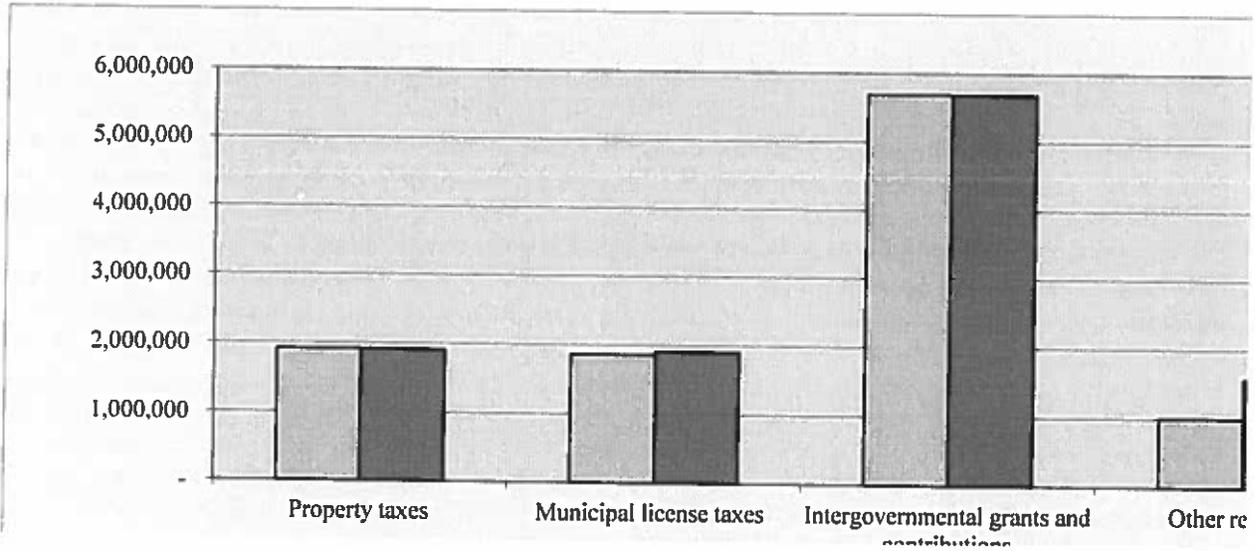
The most significant variances in actual revenues (budgetary basis) occurred with the sales and use taxes and construction excise taxes, which were \$208,935 and \$161,634, respectively, more than their respective budgeted amounts. The increase in such revenues is the direct result of an increased monitoring and auditing procedures on substantially all withholdings agents located in the Municipality during the current fiscal year and additional collection efforts adopted by the Municipality as part of such process.

For day-to-day purposes, the Municipality maintained a strict budgetary control over GF's expenditures during the current fiscal year. Expenditures and cash flows were closely monitored on a daily basis, therefore, the overall decrease in total expenses was experienced. During the current fiscal year, the Department of Finance adopted a cost reduction program that resulted an overall decrease in total expenditures referred to above.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2014

The most significant variances in actual expenditures (budgetary basis) occurred in urban and economic development expenditures, which decreased \$245,155 (6% decrease) due to the cost reduction program referred to above. For all other functions, their respective variances were not significant as their actual figures (budgetary basis) were online with their respective budgeted amounts.

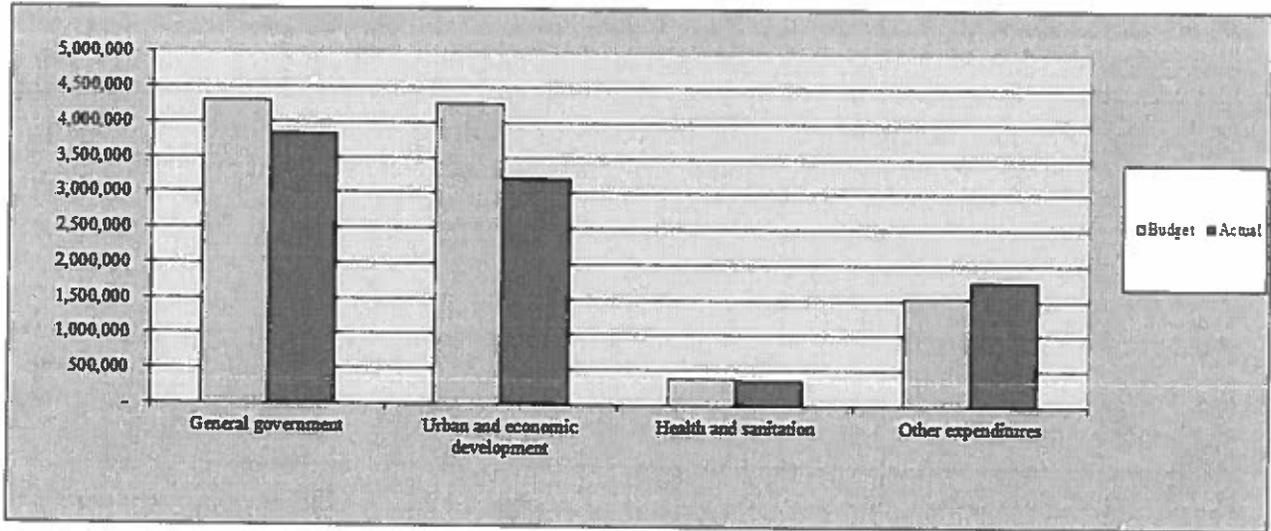
The following tables summarize the budgetary results of the revenues and expenditures of the general fund for the fiscal year ended June 30, 2014:



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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
**Management's Discussion and Analysis**  
**Fiscal Year Ended June 30, 2014**

*Budgetary Results of Expenditures – General Fund*



**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**Capital Assets**

During the current fiscal year the Municipality completed a physical inventory and valuation of its capital assets pursuant to the provisions of GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, as amended. The physical inventory and valuation resulted in a prior-period adjustment of \$12,527,582 recorded at July 1, 2013 to reduce its capital assets used in the governmental activities reported in the accompanying GWFS.

The Municipality has invested \$58,391,889 in capital assets used in governmental activities, which have an accumulated depreciation of \$19,445,618 at June 30, 2014. Capital assets increased \$1,856,245 during the current fiscal year due to the excess of current year additions (\$3,236,172) over depreciation expense (\$1,379,927) for the fiscal year ended June 30, 2014. The principal additions to capital assets for the current fiscal year were related to the municipal baseball stadium and other buildings and structures (\$2,847,032) and permanent improvements to municipal roads and other infrastructure assets (\$285,389).

We encourage readers to consider the information presented here in conjunction with more detailed capital assets information furnished in Note 9 to the accompanying notes to the financial statements.

**Debt and Long-Term Obligations Administration**

The Municipality finances a significant portion of its construction activities through bond and note issuances, and through state and federal grants. The proceeds from bond issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes.

At June 30, 2014, the Municipality's total bonded debt amounted to \$12,316,110, consisting of bonds payable. Such debt is backed by the full faith and credit of the Municipality. During the current fiscal year bonds payable decreased by \$533,500 due to the current year debt service payments.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2014

The Municipality has also certain notes payable outstanding with an aggregate outstanding balance of \$694,399, including mortgage notes payable of \$587,792. Such notes decreased \$99,935 also due to the current year debt service payments.

We encourage readers to consider the information presented here in conjunction with more detailed long-term debt information furnished in Note 11 to the accompanying notes to the financial statements.

**REQUEST FOR INFORMATION**

This financial report is designed to provide a general overview of the Municipality's finances for all of the Municipality's citizens, taxpayers, customers, investors and creditors. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Municipality of Aibonito, Department of Finance.

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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Statement of Net Position  
June 30, 2014

Assets	Governmental activities	Business-type activities	Total
<b>Current assets:</b>			
Cash in commercial banks	\$ 1,771,501	-	\$ 1,771,501
Accounts receivable, net of allowance for doubtful accounts:			
Taxes:			
Property taxes	1,070,340	-	1,070,340
Municipal license taxes	12,381	-	12,381
Construction excise taxes	39,326	-	39,326
Sales and use taxes	49,306	-	49,306
Intergovernmental grants and contributions	1,195,856	-	1,195,856
Other current assets	29,692	-	29,692
<b>Restricted assets:</b>			
Cash in commercial banks	2,079,527	72,275	2,151,802
Cash in fiscal agent	8,373,020	-	8,373,020
Property taxes receivable, net - allowance for doubtful accounts	5,337	-	5,337
Accounts receivable:			
Accrued interests on deposits	12,649	-	12,649
Intergovernmental grants and contributions	1,680,572	-	1,680,572
Other receivables	-	3,660	3,660
Other restricted current assets	-	11,229	11,229
<b>Total current assets</b>	<b>16,319,507</b>	<b>87,164</b>	<b>16,406,671</b>
<b>Non-current assets:</b>			
Capital assets, at cost:			
Non-depreciable capital assets	15,812,537	126,150	15,938,687
Depreciable capital assets, net of accumulated depreciation of \$15,752,720 and \$ 3,692,898 for governmental and business-type activities, respectively	21,667,448	1,340,136	23,007,584
Other non-current assets	-	522,675	522,675
<b>Total non-current assets</b>	<b>37,479,985</b>	<b>1,988,961</b>	<b>39,468,946</b>
<b>Total assets</b>	<b>\$ 53,799,492</b>	<b>2,076,125</b>	<b>\$ 55,875,617</b>

(Continued)

*The accompanying notes to the basic financial statements are an integral part of this statement.*

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Statement of Net Position  
June 30, 2014

<b>Liabilities</b>	<b>Governmental activities</b>	<b>Business-type activities</b>	<b>Total</b>
<b>Current liabilities (due within one year):</b>			
Accounts payable and accrued liabilities:			
Trade accounts payables and accrued liabilities	\$ 401,749	31,341	\$ 433,090
Intergovernmental payables	1,173,048	-	1,173,048
Accrued interests on bonds and notes payable	292,789	-	292,789
Liabilities related to restricted assets - accounts payable and accrued liabilities	770,248	-	770,248
Current portion of long-term obligations:			
Bonds payable	485,000	-	485,000
Mortgage and other notes	106,607	108,067	214,674
Compensated absences	610,751	-	610,751
Total current liabilities	3,840,192	139,408	3,979,600
<b>Non-current liabilities, excluding current portion (due in more than one year) :</b>			
Non-current portion of liabilities related to restricted assets:			
Bonds payable	11,831,110	-	11,831,110
Mortgage and other notes	-	479,725	479,725
Compensated absences	871,795	-	871,795
Other non-current liabilities	-	18,757	18,757
Total non-current liabilities	12,702,905	498,482	13,201,387
Total liabilities	16,543,097	637,890	17,180,987
<b>Deferred inflows of resources</b>	2,223,407	-	2,223,407
<b>Net position:</b>			
Net investment in capital assets	30,109,841	878,494	30,988,335
Restricted:			
Debt service	2,711,737		2,711,737
Capital projects	-	461,741	461,741
Federal and state funded programs	2,211,560	41,541	2,253,101
Total restricted net position	4,923,297	503,282	5,426,579
Unrestricted	(150)	56,459	56,309
Total net position	\$ 35,032,988	1,438,235	\$ 36,471,223

(Concluded)

*The accompanying notes to the basic financial statements are an integral part of this statement.*

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
**Statement of Activities**  
**Fiscal Year Ended June 30, 2014**

Functions / programs	Expenses, including depreciation	Charges for services	Program revenues		Net revenues (expenses) and changes in net position		
			Program- specific operating grants and contributions	Program- specific capital grants and contributions	Governmental activities	Business-type activities	Total
<b>Governmental activities:</b>							
General government	\$ 4,512,776	-	56,335	-	(4,456,441)	-	\$ (4,456,441)
Urban and economic development	4,254,460	84,344	19,107	571,768	(3,579,241)	-	(3,579,241)
Health and sanitation	420,333	-	-	-	(420,333)	-	(420,333)
Public safety	217,079	-	70,000	-	(147,079)	-	(147,079)
Public housing and welfare	1,210,059	-	262,617	-	(947,442)	-	(947,442)
Culture, recreation and education	1,513,675	-	247	-	(1,513,428)	-	(1,513,428)
Interests on bonds and notes payable	583,896	-	966,655	-	382,759	-	382,759
Total governmental activities	<u>12,712,278</u>	<u>84,344</u>	<u>1,374,961</u>	<u>571,768</u>	<u>(10,681,205)</u>	<u>-</u>	<u>(10,681,205)</u>
<b>Business-type activities:</b>							
Las Flores Apartments - public housing and welfare, including interests on mortgage notes payable of \$39,918	619,167	2,033	577,050	-	-	(40,084)	(40,084)
Totals	<u>\$ 13,331,445</u>	<u>86,377</u>	<u>1,952,011</u>	<u>571,768</u>	<u>(10,681,205)</u>	<u>(40,084)</u>	<u>\$ (10,721,289)</u>

General revenues:		
Taxes:		
Property taxes	\$ 2,425,225	\$ 2,425,225
Municipal license taxes	1,918,314	1,918,314
Construction excise taxes	404,867	404,867
Sales and use taxes	641,305	641,305
Total tax revenues	<u>5,389,711</u>	<u>5,389,711</u>
Intergovernmental grants and contributions, not restricted to specific programs	5,735,027	5,735,027
Interests on deposits	411,601	411,601
Miscellaneous revenues	278,927	280,388
Total general revenues	<u>11,815,266</u>	<u>11,816,727</u>
Net increase (decrease) in net position	1,134,061	1,095,438
Net position at beginning of fiscal year	46,261,369	47,738,227
Prior-period adjustments	(12,362,442)	(12,362,442)
Net position at beginning of fiscal year, as restated	33,898,927	35,375,785
Net position at end of fiscal year	<u>\$ 35,032,988</u>	<u>\$ 36,471,223</u>

The accompanying notes to the basic financial statements are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
**Balance Sheet – Governmental Funds**  
**June 30, 2014**

Assets	Major governmental funds					Total governmental funds
	General fund	Capital improvements bond fund	Legislative joint resolutions fund	Debt service fund	Other governmental funds	
Cash in commercial banks	\$ 1,771,501	-	-	-	-	\$ 1,771,501
Accounts receivable, net of allowance for doubtful accounts:						
Taxes:						
Property taxes	1,070,340	-	-	-	-	1,070,340
Municipal license taxes	12,381	-	-	-	-	12,381
Construction excise taxes	39,326	-	-	-	-	39,326
Sales and use taxes	49,306	-	-	-	-	49,306
Intergovernmental grants and contributions	1,195,856	-	-	-	-	1,195,856
Due from other governmental funds	1,600,174	-	-	-	-	1,600,174
Restricted assets:						
Cash in commercial banks	-	204,188	487,397	-	1,387,942	2,079,527
Cash in fiscal agent	-	4,641,707	-	3,269,462	461,851	8,373,020
Property taxes receivable, net of allowance for doubtful accounts	-	-	-	5,337	-	5,337
Accrued interests on deposits	-	12,377	-	219	53	12,649
Due from other governmental funds	-	-	826,803	-	502	827,305
Intergovernmental grants and contributions receivable	-	-	-	-	-	-
Total assets	\$ 5,738,884	5,035,375	1,314,200	3,489,566	3,139,269	\$ 18,717,294
<b>Liabilities</b>						
Accounts payable and accrued liabilities	\$ 401,749	-	-	-	-	\$ 401,749
Intergovernmental payables	1,173,048	-	-	-	-	1,173,048
Due to other governmental funds	827,305	-	-	-	-	827,305
Liabilities related to restricted assets:						
Accounts payable and accrued liabilities	-	692,794	-	-	77,454	770,248
Due to other governmental funds	-	1,503,873	-	40	96,261	1,600,174
Matured bonds due and payable	-	-	-	485,000	-	485,000
Matured interests due and payable	-	-	-	292,789	-	292,789
Total liabilities	2,402,102	2,196,667	-	777,829	173,715	5,550,313
<b>Deferred inflows of resources</b>	1,529,712	869	-	-	753,994	2,284,575
<b>Fund balances</b>						
Spendable:						
Assigned	578,228	-	-	-	-	578,228
Restricted	-	2,837,839	1,314,200	2,711,737	2,211,560	9,075,336
Unassigned	1,228,842	-	-	-	-	1,228,842
Total fund balances	1,807,070	2,837,839	1,314,200	2,711,737	2,211,560	10,882,406
Total liabilities, deferred inflows of resources and fund balances	\$ 5,738,884	5,035,375	1,314,200	3,489,566	3,139,269	\$ 18,717,294

The accompanying notes to the basic financial statements are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
 Reconciliation of the Balance Sheet – Governmental Funds to the Statement of Net Position  
 June 30, 2014

The amounts of governmental activities reported in the statement of net position and the balance sheet - governmental funds are different for the following reasons:

Total fund balances reported in the balance sheet - governmental funds	\$ 10,882,406
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The following assets used in governmental activities are not considered current available financial resources, therefore, are not reported in the governmental fund financial statements:

Other current assets	29,692
Capital assets net of accumulated depreciation of \$16,973,631	37,479,985

The following long-term liabilities are not due (mature) in the current fiscal year, therefore are not reported in the governmental funds at June 30, 2014:

Bonds payable	(11,831,110)
Notes payable	(106,607)
Compensated absences	(1,482,546)
Accounts payable and accrued liabilities	<u>61,168</u>

Total net position of governmental activities, as reported in the statement of net position	<u><u>\$ 35,032,988</u></u>
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*The accompanying notes to the basic financial statements are an integral part of this statement.*

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
**Statement of Revenues, Expenditures and**  
**Changes in Fund Balances – Governmental Funds**  
**Fiscal Year Ended June 30, 2014**

	Major governmental funds					Total governmental funds
	General fund	Capital improvements bond fund	Legislative joint resolutions fund	Debt service fund	Other governmental funds	
<b>Revenues:</b>						
Taxes:						
Property taxes	\$ 1,887,317	-	-	537,908	-	\$ 2,425,225
Municipal license taxes	1,918,314	-	-	-	-	1,918,314
Construction excise taxes	404,867	-	-	-	-	404,867
Sales and use taxes	641,305	-	-	-	-	641,305
Total tax revenues	4,851,803	-	-	537,908	-	5,389,711
Intergovernmental grants and contributions	5,673,859	571,768	-	966,655	408,306	7,620,588
Interests on deposits	211,113	190,432	6,519	2,738	799	411,601
Charges for services	84,344	-	-	-	-	84,344
Miscellaneous revenues	278,927	-	-	-	-	278,927
Total revenues	11,100,046	762,200	6,519	1,507,301	409,105	13,785,171
<b>Expenditures:</b>						
Current:						
General government	4,057,587	1,458	-	-	56,335	4,115,380
Urban and economic development	3,573,271	-	-	-	-	3,573,271
Health and sanitation	390,274	-	-	-	-	390,274
Public safety	124,325	-	-	-	-	124,325
Public housing and welfare	447,039	286,673	-	-	70,000	1,028,388
Culture, recreation and education	879,828	-	-	-	294,676	1,028,388
Debt service:						
Principal	-	-	-	538,500	-	538,500
Interests	-	-	-	583,896	-	583,896
Capital outlays	714,121	1,837,174	627,338	-	-	3,178,633
Total expenditures	10,186,445	2,125,305	627,338	1,122,396	421,011	14,482,495
Excess (deficiency) of revenues over (under) expenditures	913,601	(1,363,105)	(620,819)	384,905	(11,906)	(697,324)
<b>Other financing sources (uses):</b>						
Transfers from other governmental funds	254,768	294	-	-	63,552	318,614
Transfers to other governmental funds	(63,599)	(190,432)	-	(591)	(63,992)	(318,614)
Total other financing sources (uses), net	191,169	(190,138)	-	(591)	(440)	-
Net increase (decrease) in fund balances	1,104,770	(1,553,243)	(620,819)	384,314	(12,346)	(697,324)
Fund balances at beginning of fiscal year	702,300	4,391,082	1,935,019	2,327,423	2,058,766	11,414,590
Prior-period adjustments	-	-	-	-	165,140	165,140
Fund balances at beginning of fiscal year, as restated	702,300	4,391,082	1,935,019	2,327,423	2,223,906	11,579,730
Fund balances at end of fiscal year	\$ 1,807,070	\$ 2,837,839	\$ 1,314,200	\$ 2,711,737	\$ 2,211,560	\$ 10,882,406

The accompanying notes to the basic financial statements are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances –  
Governmental Funds to the Statement of Activities  
June 30, 2014

	<b>Governmental activities</b>
Total net decrease in fund balances reported in the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds	\$ (697,324)
<p>Amounts for governmental activities reported in the governmental funds financial statements differ from the amounts reported in the statement of activities for the following reasons:</p>	
Net change in deferred inflows of resources related to intergovernmental grants and contributions, which are reported as revenues in the statement of activities while are deferred in the governmental funds since are considered unavailable under the modified accrual basis of accounting.	61,168
Governmental funds report capital outlays as expenditures. However in the statement of activities the cost of those assets is capitalized and allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlay expenditures (\$3,178,633) exceeded depreciation and amortization expense (\$1,168,772) for the fiscal year ended June 30, 2014.	2,009,911
Repayment of principal of bonds and notes payable is reported as an expenditure in the governmental funds, however, the repayment reduces bonds and notes payable in the statement of net position.	538,500
Some expenses reported in the statement of activities do not require the use of current financial resources, therefore, are not reported as expenditures in the governmental funds. Those expenses are related to the net changes in the following assets and liabilities:	
Other assets	(1,785)
Accrued compensated absences	(776,409)
Net increase in net position of governmental activities, as reported in the accompanying statement of activities	\$ 1,134,061

*The accompanying notes to the basic financial statements are an integral part of this statement.*

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Statement of Fund Net Position – Proprietary Fund  
June 30, 2014

	<u>Las Flores Apartments</u>
<b>Assets</b>	
Current Assets:	
Restricted assets:	
Cash in commercial banks	\$ 72,275
Rent receivable from tenants	3,660
Other current assets	11,229
Total current assets	<u>87,164</u>
Non-current assets:	
Non-depreciable capital assets	126,150
Depreciable capital assets, net of accumulated depreciation of \$3,692,898	<u>1,340,136</u>
Total capital assets, net	1,466,286
Other non-current assets	<u>522,675</u>
Total non-current assets	<u>1,988,961</u>
Total assets	<u>\$ 2,076,125</u>
<b>Liabilities Related to Restricted Assets</b>	
Current liabilities:	
Accounts payable and accrued liabilities	\$ 31,341
Non-current liabilities due within one year - mortgage notes payable	<u>108,067</u>
Total current liabilities	<u>139,408</u>
Non-current liabilities due in more than one year:	
Tenants' security deposits	18,757
Mortgage notes payable	<u>479,725</u>
Total non-current liabilities	498,482
Total liabilities	<u>637,890</u>
<b>Fund Net Position</b>	
Net investment in capital assets	878,494
Restricted for:	
Capital projects	461,741
Federal funded programs	<u>41,541</u>
Total restricted	<u>503,282</u>
Unrestricted	<u>56,459</u>
Total fund net position	<u>\$ 1,438,235</u>

*The accompanying notes to the basic financial statements are integral part of this statement.*

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Statement of Revenues, Expenses and Changes in Fund Net Position – Proprietary Fund  
Fiscal Year Ended June 30, 2014

	<b>Las Flores Apartments</b>
Operating revenues:	
Charges for services - rental income from tenants	\$ 2,033
Miscellaneous revenues	1,461
Total operating revenues	3,494
Operating expenses - public housing and welfare:	
General, maintenance and administrative	368,044
Depreciation expense	211,205
Total operating expenses	579,249
Net operating loss	(575,755)
Non-operating revenues (expenses):	
Intergovernmental grants and contributions, not specifically restricted for capital purposes	577,050
Interests on mortgage notes payable	(39,918)
Total non-operating revenues (expenses), net	537,132
Net decrease in fund net position	(38,623)
Fund net position at beginning of fiscal year	1,476,858
Fund net position at end of fiscal year	\$ 1,438,235

*The accompanying notes to the basic financial statements are integral part of this statement.*

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Statement of Cash Flows – Proprietary Fund  
Fiscal Year Ended June 30, 2014

**Las Flores  
Apartments**

**CASH FLOWS FROM OPERATING ACTIVITIES**

Collections from tenants	\$ 5,817
Payments to suppliers	(332,843)
Other payments on operating activities	(23,122)
Net cash used in operating activities	<u>(350,148)</u>

**CASH FLOWS FROM BY NONCAPITAL FINANCING ACTIVITIES**

Collections of intergovernmental grants and contributions, not specifically restricted to capital purposes	<u>577,050</u>
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**CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES**

Acquisition, construction and improvements of capital assets	(57,539)
Principal paid on mortgage notes payable	(99,935)
Interests paid on mortgage notes payable	(39,918)
Net cash used in capital and related financing activities	<u>(197,392)</u>

**NET INCREASE IN CASH IN COMMERCIAL BANKS**

29,510

**CASH IN COMMERCIAL BANKS AT BEGINNING OF FISCAL YEAR**

42,765

**CASH IN COMMERCIAL BANKS AT END OF FISCAL YEAR**

\$ 72,275

**Reconciliation of Net Operating Loss to Net Cash Used in Operating Activities:**

Net operating loss	\$ (575,755)
Adjustments to reconcile operating loss to net cash provided (used) by operating activities:	
Depreciation expense	211,205
Net changes in assets and liabilities:	
Rent receivable from tenants	2,536
Other current and non-current assets	7,014
Accounts payable and accrued liabilities	5,065
Tenants' security deposits	(213)
Net cash used in operating activities	<u><u>\$ (350,148)</u></u>

*The accompanying notes to the basic financial statements are an integral part of this statement .*

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

**1. Government and Summary of Significant Accounting Policies**

The Municipality of Aibonito (the Municipality) is a local municipal government constituted in 1824 in the Commonwealth of Puerto Rico (the Commonwealth). The Municipality has full legislative, fiscal and all other governmental powers and responsibilities expressly assigned by Public Act No. 81 of August 30, 1991, as amended, known as *Autonomous Municipalities Act of the Commonwealth of Puerto Rico* (Act No. 81). The Municipality is one of seventy-eight municipalities legally separated from the Commonwealth's government.

The Commonwealth's Constitution provides for the separation of powers of the executive, legislative and judicial branches of the Commonwealth and the municipalities. However, the Municipality's governmental system consists of executive and legislative branches only. A Mayor, elected every four years by the citizens, exercises the executive power of the Municipality. The legislative power of the Municipality is exercised by the Municipal Legislature, whose members are also elected every four years. The judiciary power is exercised by the General Justice Court System of the Commonwealth, which has jurisdiction over the Municipality.

The Municipality assumes either partial or full responsibility for providing services to its citizens related to urban and economic development, health and sanitation, public safety, public housing and welfare, culture, recreation and education, and many other fiscal, general and administrative services.

**a. Basis of Presentation and Financial Reporting Entity**

The accompanying basic financial statements present the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Municipality of Aibonito, as of June 30, 2014, the respective changes in financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information for the fiscal year ended June 30, 2014, and the cash flows of the proprietary fund for the fiscal year ended June 30, 2014 in conformity with Accounting Principles Generally Accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB). Furthermore, the accompanying basic financial statements present the Budgetary Comparison Schedule results of the general fund for the fiscal year ended June 30, 2014 in conformity with the budgetary (statutory) basis of accounting.

The accompanying basic financial statements include all departments, agencies and municipal operational units that are under the legal and administrative control of the Mayor, and whose financial resources are under the legal custody and control of the Municipality's Director of Finance and Budget.

The Municipality follows the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units – An Amendment of GASB Statement No. 14* and GASB Statement No. 61, *The Financial Reporting Entity: Omnibus- An amended of GASB Statement No. 14 and No. 34*.

Based on the criteria set forth by those two pronouncements, the Municipality concluded that there are no legally separate entities or organizations that should be reported as component units of the Municipality as of and for the fiscal year ended June 30, 2014. The management of the

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

Municipality concluded that as of June 30, 2014 and for the fiscal year then ended, there were no legally separate entities for which the Municipality is financially accountable or entities for which their nature and significance of their relationship with the Municipality would warrant inclusion as part of the financial reporting entity of the Municipality, including any potential entity that may be closely related to, or financially integrated with the Municipality.

**b. *Financial Reporting Model***

The basic financial statements of the Municipality consist of: (1) the management's discussion and analysis (MD&A), (2) the government-wide financial statements (GWFS), (3) the governmental fund financial statements (GFFS), (4) the reconciliations of the governmental activities reported in the GWFS and the GFFS, (5) the proprietary fund financial statements (PFFS), and (7) the notes to basic financial statements.

The MD&A is a required supplementary information presented along with, but separate from, the Municipality's basic financial statements. *MD&A* is a narrative report that introduces the accompanying basic financial statements and provides an analytical overview of the Municipality's financial activities for the fiscal year ended June 30, 2014, based on the Municipality's knowledge of the transactions, events and conditions reflected in the basic financial statements. The MD&A also highlights certain key fiscal policies that control the Municipality's operations.

Other supplementary information presented in this report for purposes of additional analysis consist of: (1) the schedule of expenditures of federal awards, and (2) the budgetary comparison schedule – general fund, as listed in the accompanying table of contents.

**c. *Government-Wide Financial Statements***

The accompanying GWFS are composed of: (1) the statement of net position and (2) the statement of activities. These financial statements report information of all governmental and business-type activities of the Municipality as a whole. These statements are aimed at presenting a broad overview of the Municipality's finances by reporting its financial position and results of operations using methods that are similar to those used by most private businesses.

The focus of GWFS is on the operational accountability of the Municipality as a single economic unit and not on compliance with budgets, regulatory requirements or on the use of available or currently expendable financial resources (referred to as fiscal accountability). Operational accountability is the Municipality's responsibility to report to the extent to which it has met its operating objectives efficiently and effectively, using all resources available for that purpose. It focuses on the Municipality's principal operating objective, which is to provide services to its citizens.

The accompanying statement of net position provides short-term and long-term information about the Municipality's financial position by presenting all of the Municipality's assets, liabilities and deferred inflows of resources, with the difference between these three items reported as "net position". This statement assists management in assessing the level of services that can be provided by the Municipality in the future and its ability to meet its obligations as they become

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

due. In addition, this statement reports the extent to which the Municipality has invested in capital assets and discloses legal and contractual restrictions on resources.

Net position is classified in the accompanying statement of net position within the following three categories:

- **Net investment in capital assets** – This component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of bonds, mortgages, notes and other debts that are attributed to the acquisition, construction or improvement of those assets. For the purposes of determining the outstanding debt attributed to capital assets, the total debt related to the acquisition, construction or improvement of capital assets has been reduced by any related unspent debt proceeds and any unamortized debt issuance costs. Pursuant to the provisions of GASB 63, deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction or improvement of those assets is included in this component of net position.

In addition, for the purposes of determining the outstanding debt attributed to capital assets, the following items are excluded from the calculation: (1) bond issuance costs, (2) interest payable, (3) accrued interest on deep discount debt and non-capital accrued liabilities (e.g. compensated absences, claims and judgments, etc.), and (5) debt used to finance capital acquisitions by parties outside the Municipality. Furthermore, the computation of net investment in capital assets, net of related debt, excludes inter-fund loans and other financial assets.

- **Restricted net position** – This component of net position consists of assets reduced by liabilities and deferred inflows of resources that are restricted by external parties (such as debt covenants, creditors, grantors, contributors, laws or regulations of other governments, etc.), or net position for which constraints are imposed by constitutional provisions or enabling legislation. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported.

Enabling legislation consists of legislation that authorizes the Municipality to assess, levy, charge or otherwise mandate payment of resources (from external resource providers). Enabling legislation establishes restrictions if it includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.

On July 1, 2005, the Municipality adopted the provisions of Statement No. 46, *Net Assets Restricted by Enabling Legislation* (GASB No. 46). This Statement requires that limitations on the use of net position imposed by enabling legislation be reported as restricted net position. This Statement clarified that a legally enforceable enabling legislation restriction is one that a party external to the Municipality (such as citizens, public interest groups, or the judiciary) can compel the Municipality to honor. This Statement states that the legal enforceability of an enabling legislation should be reevaluated if any of the resources raised by the enabling legislation are used for a purpose not specified by the enabling legislation or if the Municipality has other cause for consideration. Although the determination that a particular restriction is not legally enforceable may cause the Municipality to review the

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

enforceability of other restrictions, it should not necessarily lead the Municipality to the same conclusion for all enabling legislation restrictions.

The classification of restricted net position identifies resources that have been received or earned by the Municipality with an explicit understanding between the Municipality and the resource providers that the resources would be used for specific purposes. Grants, contributions and donations are often given under those kinds of conditions. Bond indentures also often limit the use of bond proceeds to specific purposes.

Internally imposed designations of resources, including earmarking, are not reported as restricted net position. These designations consist of management's plans for the use of resources, which are subject to change at the discretion of the Municipal Legislature.

The Municipality has reported the following types of restricted net position in the accompanying statement of net position and the statement of fund net position – proprietary fund as of June 30, 2014:

- (1) **Debt service** – Represent net resources restricted by bond indentures, debt covenants or certain laws and regulations that are available to cover future debt service payments of bonds, mortgages and notes payable.
  - (2) **Capital projects** – Represent net resources that are available to cover the cost of the acquisition, construction and improvement of major capital assets.
  - (3) **Federal and state funded programs** – Represent net resources externally restricted by grantors, contributors, creditors or certain laws and regulations that are available to carry out specific purposes of several federal and state funded programs.
- **Unrestricted** – This category consists of the excess of liabilities and deferred inflows of resources over the related assets that are neither externally or legally restricted, nor invested in capital assets. However, assets reported within unrestricted net position often are designated to indicate that management does not consider them to be available for general operations. Generally, the assets recorded within this category are designated to indicate that management does not consider them to be available for general operations. Assets reported within this category often have constraints that are imposed by management but can be removed or modified.

When both restricted and unrestricted resources are available for use, it is the Municipality's policy to generally use restricted resources first, and then unrestricted resources as they are needed. When unrestricted resources are used, it is the Municipality's policy to use assigned resources first and then unassigned resources as they are needed.

The accompanying statement of activities presents the Municipality's results of operations by showing, how the Municipality's net position changed during the fiscal year ended June 30, 2014, using a net (expense) revenue format. This statement presents the cost of each function/program as well as the extent to which each of the Municipality's functions, programs or other services either contributes to or draws from the Municipality's general revenues (such as property taxes, municipal license taxes, construction excise taxes, sales and use taxes, etc.).

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

A function/program describes a group of activities that are aimed at accomplishing a major service or regulatory responsibility. The functions/programs reported in the accompanying basic financial statements are: (1) general government, (2) urban and economic development, (3) public safety, (4) health and sanitation, (5) culture, recreation and education and (6) public housing and welfare. The governmental operations of the Municipality's departments and operational units are classified within the following functions/programs in the accompanying basic financial statements:

***General government:***

- Municipal legislature
- Mayor's office
- Department of finance and budget
- Department of human resources
- Department of municipal secretary
- Department of internal audit
- Department of purchasing and supplies

***Urban and economic development:***

- Department of public works
- Department of transportation and maintenance
- Department of engineering

***Health and sanitation:***

- Department of recycling and environmental control

***Public safety:***

- Department of emergency management
- Department of municipal police

***Public housing and welfare:***

- Department of elderly services
- Department of service to citizens

***Culture, recreation and education:***

- Department of recreation and sports
- Department of culture and tourism

The statement of activities demonstrates the degree to which program revenues offset direct expenses of a given function/program or segments. Direct expenses are those that are clearly identifiable with a specific function, segment or operational unit. This statement reports revenues in two broad categories: (1) program revenues and (2) general revenues.

Program revenues are generated directly from a program itself or may come from parties outside the Municipality's taxpayers or citizens. In the statement of activities, program revenues reduce

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

the costs (expenses) of the function/program to arrive at: (1) the net cost of the function/program that must be financed from the Municipality's general revenues or (2) the net program revenue that contributes to the Municipality's general revenues.

The accompanying statement of activities reports the following categories of program revenues for the fiscal year ended June 30, 2014:

- **Charges for services** – These revenues generally consist of exchange or exchange-like transactions involving charges to customers or applicants who purchase, use or directly benefit from the goods, services or privileges provided, or are otherwise directly affected by the services. These revenues include fees charged for specific services, charges for licenses and permits, and fines and forfeitures, among others.
  
- **Program-specific operating and capital grants and contributions** – These revenues consist of transactions that are either mandatory or voluntary non-exchange transactions with other governments, organizations, or individuals that restrict the resources for use in a particular program. Operating grants and contributions consist of resources that are required to be used to finance the costs of operating a specific program or can be used either for operating or capital purposes of a specific program. Capital grants and contributions consist of revenues or resources that are restricted for capital purposes – to purchase, construct or renovate capital assets associated with a specific program. Restricted operating and capital grants and contributions are program revenues because they are specifically attributable to a program and reduce the net expense of that program to the Municipality. They are reported net of estimated uncollectible amounts.

General revenues are the default category for revenues. It includes all revenues and gains that do not meet the definition of program revenues. Property taxes, municipal license taxes, sales and use taxes, and construction excise taxes are reported as general revenues. All other non-tax revenues (including unrestricted interests on deposits, intergovernmental grants and contributions not restricted for specific programs and miscellaneous revenues) that do not meet the definition of program revenues are classified as general revenues. Resources that are dedicated internally by the Municipality are reported as general revenues rather than as program revenues. All general revenues are reported net of estimated uncollectible amounts, which are recorded as reduction of revenues rather than as expenses.

The general government function/program reported in the accompanying statement of activities includes expenses that are, in essence, indirect or costs of other functions/programs of the Municipality. Even though some of these costs have been charged to certain funds in the GFFS as indirect cost allocations permitted under some federal programs, the Municipality has reported these indirect costs as direct expenses of the general government function. Accordingly, the Municipality generally does not allocate general government (indirect) costs to other functions.

The effects of all inter-fund governmental and business-type activities (revenues, expenditures/expenses and other financing sources/uses among governmental/proprietary funds) have been removed from the accompanying statements of net position and activities. Inter-fund services provided and used have not been eliminated in the process of consolidation.

The Municipality classifies its activities as governmental or business-type activities in the accompanying GWFS. These are activities generally financed through taxes, intergovernmental

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

revenues and other non-exchange revenues that can be used to support the Municipality's programs or services. These governmental activities are also generally reported in the GFFS while the business-type activities are also reported in the PFFS.

The Municipality has no fiduciary activities, which are those in which the Municipality would be holding or managing net position for specific individuals or other external parties in accordance with trust agreements or other custodial arrangements. In addition, the Municipality has no operations or activities that are financed and operated in a manner similar to private business enterprises, where the costs of providing goods or services to the general public (expenses, including depreciation) is financed primarily through user charges; or where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

*d. Governmental Fund Financial Statements*

A fund is a fiscal and accounting entity consisting of a self-balancing set of accounts used to record assets, liabilities and residual equities, deficits or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with GAAP and/or special regulations, restrictions or limitations.

The accompanying governmental fund financial statements (GFFS) are composed of: (1) the balance sheet – governmental funds, and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds.

These balance sheet – governmental funds and the statement of revenues, expenditures and changes in fund balances – governmental funds report the financial position and results operations of the Municipality's governmental funds by presenting sources, uses and balances of current financial resources.

The accompanying GFFS segregate governmental funds according to their intended purpose and are used in demonstrating compliance with legal, financial and contractual provisions. The minimum number of governmental funds is maintained consistent with legal and self-imposed managerial requirements established by the Municipality.

The GFFS are oriented to the fiscal accountability and the individual parts of the Municipality's government. Fiscal accountability represents the Municipality's responsibility to justify that its actions in the current fiscal year have complied with public decisions concerning the raising and spending of public moneys in the short term (generally one fiscal year).

The focus of the GFFS is on major governmental funds, which generally represent the Municipality's most important funds. Accordingly, the Municipality is required to segregate governmental funds between major and non-major categories within the GFFS. Major individual governmental funds are reported individually as separate columns in the GFFS, while data from all non-major governmental funds are aggregated into a single column, regardless of fund type. By definition, the Municipality's general fund is considered a major governmental fund for financial reporting purposes. In addition, any other governmental fund would be classified as a major governmental fund in the GFFS if its total assets and deferred outflows of resources,

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

liabilities and deferred inflows of resources, revenues or expenditures of that individual governmental fund are at least ten percent (10%) of the corresponding element total (assets and deferred outflows of resources, liabilities and deferred inflows of resources, revenues or expenditures) for all governmental funds, and if its total assets and deferred outflows of resources, liabilities and deferred inflows of resources, revenues or expenditures of that individual governmental fund are at least five percent (5%) of the corresponding element total for all governmental and proprietary funds. For the purposes of applying the aforementioned major fund criteria, no eliminations of inter-fund balances have been made. Total revenues for these purposes means all revenues, including operating and non-operating revenues (net of allowances for uncollectible accounts), except for other financing sources. Total expenditures for these purposes mean all expenditures, including operating and non-operating expenditures, except for other financing uses.

In the case of the proprietary funds, when applying the aforementioned major fund criteria, revenues and expenses include all operating statement revenues and expenses (both operating and non-operating) including capital contributions, special items, but not extraordinary items.

Furthermore, any other non-major governmental fund would be reported as a major governmental fund in the GFFS if such fund is considered of significant interest to regulations or investors of the Municipality, as it is the case of the capital improvements bond fund described below.

Based on the aforementioned criteria, the Municipality's major governmental funds reported in the accompanying GFFS are: (1) the general fund, (2) the capital improvements bond fund, (3) the legislative joint resolutions fund, and (4) the debt service fund. In addition, Las Flores Apartments has been reported separately from governmental funds, as the only proprietary fund of the Municipality.

The Municipality reported the following major governmental funds in the accompanying GFFS:

- **General Fund** – The general fund is the Municipality's main operating fund used to account for all financial resources and governmental activities, except for financial resources required to be accounted for in another fund. It is presumed that the Municipality's governmental activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) GAAP requirements or (3) the demands of sound financial administration requiring the use of a governmental fund other than the general fund.
- **Capital Improvements Bond Fund** – The capital improvements bond fund is a capital projects fund used to account for the financial resources arising mainly from bonds and notes issuance proceeds used in the acquisition, construction or improvement of major capital assets. Generally, the most significant transactions of this fund are related to capital outlays and debt proceeds.
- **Legislative Joint Resolutions Fund** - The legislative joint resolutions fund is a major capital projects fund used to account for the financial resources arising from program-specific capital grants and contributions awarded by the Legislature of the Commonwealth of Puerto Rico, which are principally used in the acquisition or construction of major capital facilities, other

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

assets and permanent improvements. Generally, the most significant transactions of this fund are related to capital outlays and intergovernmental grants and contributions revenues.

- **Debt Service Fund** – The debt service fund is used by the Municipality to account for the accumulation of resources for, and the payment of, principal and interest for: (1) bonds payable for which debt service payments are legally mandated to be accounted for in a debt service fund and/or (2) bonds payable or any general long-term debt for which the Municipality is being accumulating financial resources in advance to pay principal and interest payments maturing in future years. Consistently with the prior fiscal years' financial statement presentation, during the fiscal year ended June 30, 2014, the financial activity accounted for in the debt service fund was specifically related to bonds payable.

The outstanding balance of general long-term debts for which debt service payments do not involve the advance accumulation of resources (such as obligations under capital leases) are only accounted for in the accompanying statement of net position. The debt service payments of such debts are generally accounted for as debt service – principal and debt service – interest expenditures in the general fund.

The non-major governmental funds of the Municipality are composed of special revenue funds and capital project funds. The special revenue funds are used by the Municipality to account for revenues derived from operating grants, contributions or other revenue sources that are either self-restricted or committed by the Municipality or legally restricted by outside parties for use in specific purposes (except for revenues that are earmarked for expenditures in debt service and capital projects, which are accounted for in the debt service fund and the capital projects funds, respectively). The uses and limitations of each special revenue fund are specified by municipal ordinances or federal and state statutes. However, resources restricted to expenditures for purposes normally financed from the general fund are reported in the Municipality's general fund provided that all applicable legal requirements are appropriately satisfied. In this case, a special revenue fund to account for such kind of transactions will be used only if legally mandated.

The non-major capital projects funds are used to account for federal and state intergovernmental capital grants and contributions used for the acquisition, construction or improvement of capital assets. Significant capital outlays financed from proceeds of general obligation, public improvement or special obligation bonds accounted for also in the capital projects funds.

The use of the capital projects funds in the accompanying financial statements has been reserved only for major capital acquisitions, construction or improvement activities that would distort financial resources trend data if not reported separately from the other Municipality's operating activities. The routine purchases of minor capital assets (such as furniture, office equipment, vehicles and other minor capital assets or improvements) have been reported in the governmental fund from which financial resources were used for the payment.

The Municipality periodically undertakes a comprehensive evaluation of its fund structure to ensure that complies with all aspects that are of importance to users of general purpose external financial reports. Consequently, all superfluous funds and some internal funds currently used by Municipality in the day-to-day accounting procedures have not been reported as individual governmental funds in the accompanying fund financial statements. Accordingly, the accompanying fund financial statements include only the minimum number of funds consistent

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

with legal and operating requirements and, consequently, the following types of similar internal funds have been combined into single funds in the accompanying fund financial statements:

- The various capital improvements bond issues outstanding have been reported as a single major capital projects fund.
- Program-specific capital grants and contributions awarded by the Legislature of the Commonwealth of Puerto Rico have been combined into a single major capital projects fund, the legislative joint resolutions fund.

The accompanying GFFS are accompanied by the following schedules required by GAAP: (1) the reconciliation of the balance sheet – governmental funds to the statement of net position, and (2) the reconciliation of the statement of revenues, expenditures and changes in fund balances – governmental funds to the statement of activities.

As required by GASB No. 34, the proprietary fund of the Municipality applies all pronouncements issued by the Financial Accounting Standards Board (FASB) and its predecessor bodies, such as the Accounting Principles Board (APB) and the Committee on Accounting Procedures, issued on or before November 30, 1989, provided those pronouncements do not conflict with or contradict the Standards of the Governmental Accounting Standards Board. However, the Municipality has elected to continue following more recent FASB guidance, provided it neither conflicts nor contradicts GASB pronouncements.

*e. Proprietary Fund Financial Statements*

The proprietary fund financial statements (PFFS) consist of: (1) the statement of fund net position – proprietary fund, (2) the statement of revenues, expenses and changes in fund net position – proprietary fund, and (3) the statement of cash flows – proprietary fund. These statements present the financial position, results of operations and cash flows of *Las Flores Apartments Fund* (FmHA and HUD Project No. 63-005-660-43-3572), which accounts for the leasing operations and maintenance of a residential real estate property originally acquired through the issuance of mortgage notes payable.

*f. Measurement Focus and Basis of Accounting*

- 1) **Government-wide financial statements** – The accompanying GWFS are reported using the economic resources measurement focus and the accrual basis of accounting. Subject to the additional rules and limitations detailed below, revenues (including interests on deposits) are generally recorded when earned and expenses are generally recorded when a liability is incurred, regardless of the timing of related cash flows.

All revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are generally recorded when the exchange takes place. In exchange transactions, each party to the transaction receives and gives up essentially equal values. An exchange-like transaction is one in which there is an identifiable exchange and the values exchanged, though related, may not be quite equal. Nevertheless, the exchange characteristics of the exchange-like transaction are strong enough to justify treating it as an exchange for accounting purposes (examples include fees for licenses and permits, charges

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

for services, and miscellaneous revenues, which are recorded as revenues when collected because they are generally not measurable until actually received).

All revenues, expenses, gains, losses and assets resulting from non-exchange transactions are recorded using the criteria set forth by GASB Statement No. 33, *Accounting and Financial Reporting for Non-exchange Transactions* (GASB No. 33). GASB No. 33 established accounting and reporting standards for non-exchange transactions involving cash and financial or capital resources (for example, most taxes, grants and private donations). In a non-exchange transaction, the Municipality gives (or receives) value without directly receiving (or giving) equal value in return. This is different from an exchange transaction, in which each party receives and gives up essentially equal values. According to GASB No. 33, the Municipality groups its non-exchange transactions into the following four classes in the accompanying basic financial statements: (a) derived tax revenues, (b) imposed non-exchange revenues, (c) government mandated non-exchange transactions, and (d) voluntary non-exchange transactions.

In the case of derived tax revenue transactions, which result from assessments the Municipality places on exchange transactions, receivables and revenues are recorded when the underlying exchange has occurred.

In the case of imposed non-exchange revenue transactions (such as property taxes, municipal license taxes, sales and use taxes and construction excise taxes), which result from assessments made by the Municipality on non-governmental entities, including individuals, other than assessments on exchange transactions, receivables are generally recorded in the period when an enforceable legal claim has arisen. Property taxes and municipal license are generally recorded as revenues (net of amounts considered not collectible) in the fiscal year when resources are required to be used or the first fiscal year that the use of the resources is permitted.

Government-mandated non-exchange transactions (such as grants and contributions) result when a government at one level (such as the federal or state government) provides resources to the Municipality and the provider government requires the Municipality to use those resources for a specific purpose or purposes established in the provider's enabling legislation. In these type of transactions, receivables and revenues are generally recorded when all eligibility requirements imposed by the provider have been met. For the majority of grants, the Municipality must expend resources on the specific purpose or project before the provider reimburses any amounts. Revenue is, therefore, generally recognized as qualifying reimbursable expenditures are incurred.

Voluntary non-exchange transactions (such as donations and certain grants and entitlements) result from legislative or contractual agreements, other than exchanges, willingly entered into by two or more parties. In these types of transactions, receivables and revenues are generally accounted for in the same manner as government-mandated non-exchange transactions discussed above. Events that are neither exchange nor non-exchange transactions are recorded when it is probable that a loss has been incurred and the amount of loss is reasonably estimable.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

Receipts of any type of revenue sources collected in advance for use in the following fiscal year are recorded as deferred inflows of resources pursuant to the provisions of GADB 63.

According to GASB No. 34, all general capital assets and the un-matured long-term liabilities are recorded only in the accompanying statement of net position. The measurement focus and the basis of accounting used in the accompanying GWFS differ significantly from the measurement focus and basis of accounting used in the preparation of the accompanying GFFS. Therefore, the accompanying GFFS include reconciliations, as detailed in the accompanying table of contents, to better identify the relationship between the GWFS and the GFFS.

- 2) **Governmental fund financial statements** – The accompanying GFFS are reported using the current financial resources measurement focus (flow of current financial resources) and the modified accrual basis of accounting. Accordingly, the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds, reports changes in the amount of financial resources available in the near future as a result of transactions and events of the fiscal year reported. Therefore, revenues are generally recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current fiscal year or soon enough thereafter to pay liabilities of the current fiscal year. For this purpose, the Municipality generally considers most revenues (municipal license taxes, construction excise taxes, sales and use taxes, interests on deposit, intergovernmental grants and contributions and certain charges for services) to be available if collected within 90 days after June 30, 2014, except for property taxes for which the availability period is 60 days. Revenue sources not meeting this availability criterion or collected in advance are recorded as deferred inflows of resources at June 30, 2014.

The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, sales and use taxes, construction excise taxes, intergovernmental grants and contributions, interests on deposits, and charges for services. These principal revenue sources meet both measurability and availability criteria in the accompanying GFFS, except for amounts recorded as deferred inflows of resources.

In a manner similar to the GWFS, but subject to and limited by the availability criteria discussed above, all revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are also generally recorded when the exchange takes place.

Accordingly, fees for licenses and permits, charges for services and miscellaneous revenues are recorded as revenues when collected because they are generally not measurable until actually received.

All revenues, expenses, gains, losses and assets resulting from non-exchange transactions are recorded in a similar manner to the GWFS, using the previously discussed criteria set forth by GASB No. 33 for non-exchange transactions, but subject to and limited by the availability criteria discussed above. Accordingly, property tax and municipal license taxes receivables are also generally recorded in the fiscal year when an enforceable legal claim has arisen while property tax and municipal license tax revenues (net of amounts considered not collectible) are also generally recorded in the fiscal year when resources are required to be used or the

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

first fiscal year that the use of the resources is permitted. Receivables and revenues from federal and state grants and contributions, donations and entitlements are also generally recorded when all eligibility requirements imposed by the provider have been met (generally, as qualifying reimbursable expenditures are incurred for expenditure-driven grants).

Interests on deposits are recorded when earned since these revenues are considered both measurable and available at June 30, 2014.

Pursuant to the provisions of GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* (GASBI No. 6), in the absence of an explicit requirement (i.e., the absence of an applicable modification, discussed below) the Municipality generally accrues a governmental fund liability and expenditure (including salaries, professional services, supplies, utilities, etc.) in the period in which the government incurs the liability, to the extent that these liabilities are normally expected to be liquidated in a timely manner and in full with current available financial resources. GASBI No. 6 modified the recognition criteria for certain expenditures and liabilities reported under the modified accrual basis of accounting prior to GASB No. 34, and clarified a number of situations in which the Municipality should distinguish between governmental fund liabilities and general long-term liabilities. Therefore, the accompanying balance sheet – governmental funds generally reflects only assets that will be converted into cash to satisfy current liabilities. Long-term assets and those assets that will not be converted into cash to satisfy current liabilities are generally not accounted for in the accompanying balance sheet – governmental funds. At the same time, long-term liabilities (generally, those un-matured that will not require the use of current financial resources to pay them) are not accounted for in the accompanying balance sheet – governmental funds.

Modifications to the accrual basis of accounting in accordance with GASB No. 6 include:

- Principal and interest on bonds and notes payable are recorded when they mature (when payment is due), except for principal and interest of bonds due on July 1, 2014, which are recorded as governmental fund liabilities of the debt service fund at June 30, 2014 which is the date when resources were available in the debt service fund.
- Obligations under compensated absences, are recorded only when they mature (when payment is due).
- Certain accounts payable, intergovernmental payables and other accrued liabilities not due and payable (un-matured) or not normally expected to be liquidated in full and in a timely manner with available and expendable financial resources, are recorded in the accompanying statement of net position. Such liabilities are recorded in the governmental funds when they mature.
- Executory purchase orders and contracts are recorded as a reservation of fund balance in the GFFS.

The measurement focus of the GFFS is on decreases of net financial resources (expenditures) rather than expenses. Most expenditures are measurable and are recorded when the related governmental fund liability is incurred. Allocation of costs, such as depreciation and

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

amortization, are recorded in the accompanying statement of activities, but are not recorded in the accompanying GFFS.

- 3) **Proprietary Fund Financial Statements** – The accompanying proprietary fund financial statements (PFFS) are reported using the economic measurement focus and the accrual basis of accounting, similar to the GWFS described above. Revenues are recorded when earned and expenses are recorded when incurred, regardless of when cash is received or paid. The statement of revenues, expenses and changes in net position distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. The major operating revenue of the Municipality's proprietary fund is from rent charges collected from tenants.

Pursuant to the provisions of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, Las Flores Apartments Fund has elected to not apply all nongovernmental financial accounting pronouncements issued after November 30, 1989 to its business-type activities and PFFS.

*g. Stewardship, Compliance and Accountability*

**Budgetary Control**

According to Act No. 81, the Mayor and its Administrative Cabinet prepare annual budgets each fiscal year for the Municipality's general fund and debt service fund. Such legally adopted budgets are based on expected expenditures by program and estimated resources by source. The annual budgets are developed using elements of performance-based program budgeting and zero-based budgeting, and include estimates of revenues and other resources for the ensuing fiscal year under laws and regulations existing at the time the budgets are prepared.

The Mayor must submit, for the fiscal year commencing on the next July 1, an annual budgetary resolution project (the Project) to the Commissioner of Municipal Affairs of the Commonwealth (the Commissioner) and the Municipal Legislature no later than May 10 and May 15, respectively. The Commissioner preliminarily verifies that the Project complies with all the applicable laws and regulations and may provide comments and suggestions to the Mayor on or before June 13.

The Municipal Legislature has ten (10) business days, up to the immediately preceding June 13, to discuss and approve the Project with modifications. The Municipal Legislature may amend the budgets submitted by the Mayor but may not increase any items so far to cause a deficit without imposing taxes or identifying other sources of revenue to cover such deficit. After the Municipal Legislature modifies and preliminarily approves the Project, the modified Project is sent back to the Mayor for his approval or rejection within six (6) days. The Mayor may decrease or eliminate any line item but may not increase or insert any new line item in the budgets. The Mayor may also veto the budgets in their entirety and return it to the Municipal Legislature with his objections. If the Mayor rejects the Project, the Municipal Legislature will have up to eight (8) days to adopt or reject the recommendations or objections of the Mayor. The approved Project is

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

sent again to the Mayor, which then would have three (3) days to sign and approve it. If the budgets are not adopted prior to the end of the deadlines referred to above, the annual budgets for the preceding fiscal year, as approved by the Legislature and the Mayor, are automatically renewed for the ensuing fiscal year until the Municipal Legislature and the Mayor approve new budgets. This permits the Municipality to continue doing payments for its operations and other purposes until the new budgets are approved.

The annual budgets may be updated for any estimate revisions as well as fiscal year-end encumbrances, and may include any additional information requested by the Municipal Legislature. The Mayor may request subsequent amendments to the approved budgets, which are subject to the approval of the Municipal Legislature.

The Municipality's Department of Finance and Budget has the responsibility to ensure that budgetary spending control is maintained. For day-to-day management control purposes, expenditures plus encumbrances may not exceed budgeted amounts at the expenditure-type level of each cost center (activity within a program within a fund). The Mayor may transfer unencumbered appropriations within programs within funds. The Municipal Legislature may transfer amounts among programs within and among funds.

The legal level of budgetary control (i.e., the level at which expenditures may not legally exceed appropriation) is at the functions/program level (general government, urban and economic development, public safety, health and sanitation, culture, recreation and education, and public housing and welfare, capital outlays, principal expenditures, interest expenditures, etc.) within the general and debt service funds, respectively.

Under the laws and regulations of the Commonwealth, the appropriations made for any fiscal year shall not exceed the total revenue, including available surplus, estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided.

#### **Budgetary Accounting**

The Municipality's annual budgets are prepared using the budgetary (statutory) basis of accounting, which is not in accordance with GAAP.

According to the budgetary basis of accounting, revenue is generally recorded when cash is received. Short-term and long-term borrowings may be used to finance budgetary excess of expenditures over revenues.

The Municipality uses encumbrance accounting to record the full amount of purchase orders, contracts and other commitments of appropriated resources as deductions from the appropriation prior to actual expenditure. In the governmental funds, encumbrance accounting is a significant aspect of budgetary control. Accordingly, expenditures are generally recorded when the related expenditure is incurred or encumbered. Available appropriations and encumbrances are established to lapse one fiscal year after the end of the fiscal year. Amounts required to settle claims and judgments against the Municipality, and certain other liabilities, are not recognized until they are encumbered or otherwise processed for payment. Unencumbered appropriations and encumbrances lapse at fiscal year-end. Other appropriations, mainly capital projects appropriations, are continuing accounts for which the Municipal Legislature has authorized that

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

an unspent balance from the prior year be carried forward and made available for current spending.

The accompanying Budgetary Comparison Schedule – general fund, provides information about the general fund’s original budget, its amendments, and the actual results of operations of such governmental fund under the budgetary basis of accounting for the fiscal year ended June 30, 2014. Further details of the Municipality’s budgetary control at the legal level may be obtained from the Budgetary Liquidation Report for the fiscal year ended June 30, 2014, which is prepared by the Municipality’s Department of Finance and Budget. Copies of that report may be obtained by writing to the Municipality’s Director of Finance and Budget.

Because accounting principles applied for the purposes of the developing data on a budgetary basis differ significantly from those used to present the governmental fund financial statements in conformity with GAAP, a reconciliation of the differences between the general fund’s budgetary basis and GAAP actual amounts is presented as follows:

Excess of revenues and other financing sources over expenditures and other financing uses – budgetary basis – general fund	\$1,293,576
Timing difference - net effect of current year encumbrances recorded as expenditures for budgetary purposes versus prior year encumbrances recorded as current year expenditures for GAAP purposes	(2,090,799)
Basis of accounting differences (net changes in the following assets, liabilities and deferred inflows of resources):	
Property taxes receivable	(25,994)
Municipal license taxes receivable	9,782
Construction excise taxes receivable	36,758
Sales and use taxes receivable	10,852
Intergovernmental grants and contributions receivable	(16,709)
Accounts payable, accrued liabilities and intergovernmental payables	77,187
Due to other governmental funds	1,900,733
Due from other governmental funds	(154,376)
Deferred inflows of resources	63,760
Excess of revenues and other financing sources over expenditures and other financing uses-budgetary basis-general fund	\$1,104,770

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COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

*h) Unrestricted and Restricted Deposits*

The Municipality's deposits at June 30, 2014 are composed of: (1) demand deposits in commercial banks and (2) demand deposits in the Government Development Bank for Puerto Rico (GDB), fiscal agent.

Cash in commercial banks of \$1,771,501 in the general fund is available to meet current operating requirements of the Municipality and any excess, if any, is generally invested in certificates of deposit in commercial banks with original maturities of three months or less.

Under the laws and regulations of the Commonwealth, public funds deposited by the Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the federal depository insurance generally provided by the Federal Deposits Insurance Corporation (FDIC). All securities pledged as collateral are held by agents designated by the Commonwealth's Secretary of the Treasury, but not in the Municipality's name.

Cash in fiscal agent in the debt service fund consists principally of property tax and intergovernmental grants and contributions collections amounting to \$3,269,462 that are restricted for the payment of the Municipality's debt service, as required by law.

Cash in fiscal agent recorded in the capital improvements bond fund consists mainly of unspent proceeds of bonds amounting to \$4,641,707 that are restricted for the acquisition, construction or improvements of major capital assets.

Restricted cash in commercial banks amounting to \$204,188 in the capital improvements bond fund represents mainly the balance of unspent debt proceeds held in interests and non-interests bearing accounts that are restricted to finance the operations of certain federal and state funded programs.

Restricted cash in commercial banks in the legislative joint resolutions fund consists of unspent program-specific capital grants and contributions amounting to \$487,397 awarded by the Legislature of the Commonwealth of Puerto Rico that are mainly restricted for the acquisition, construction or improvements of major capital assets.

Restricted cash in commercial banks for other governmental funds, amounting to \$1,387,942, represents the balance of non-interest bearing accounts restricted to finance the operations of various federal and state funded grant programs.

Restricted cash in fiscal agent amounting to \$461,851 represents the balance of unspent capital grants and bond proceeds held in non-interest bearing accounts that are restricted to finance the operations of various federal programs and capital project.

Restricted cash in commercial banks in the statement of fund net position – proprietary fund (Las Flores Apartments), amounting to \$72,275, represents the balance of interests and non-interests bearing accounts restricted to finance the residential project operations.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

*i) Unrestricted and Restricted Accounts Receivable*

Receivables consist of all revenues earned but not collected at June 30, 2014. These accounts receivable are stated net of estimated allowances for uncollectible accounts, which are determined based upon past collection experience, historical trends, current economic conditions and the periodic aging of accounts receivable.

Intergovernmental grants and contributions receivable represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally and state funded programs.

Pursuant to the provisions of GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues of Intra-Entity Transfers of Assets and Future Revenues* (GASB 48), transactions in which the Municipality is willing to exchange an interest in its expected future cash flows from collecting specific receivables or specific future revenues for immediate cash payments, generally, a single lump sum are either regarded as a sale or as a collateralized borrowing resulting in a liability depending on its continuing involvement with those receivables or future revenues. Accordingly, a transaction will be reported as a collateralized borrowing unless the criteria indicating that a sale has taken place are met. If it is determined that a transaction involving receivables should be reported as a sale, the difference between the carrying value of the receivables and the proceeds should be recognized in the period of the sale in the accompanying statement of activities, the statement of revenues, expenditures and changes in fund balances – governmental funds and the statement of revenues, expenses and changes in net position – proprietary fund. If it is determined that a transaction involving future revenues should be reported as a sale, the revenue is deferred and amortized, except when specific criteria are met. According to the criteria set forth by GASB No. 48, there were no transactions involving receivables that should be reported as a sale as of and for the fiscal year ended June 30, 2013.

Activities among governmental funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as “due to/from other funds”.

*j) Capital Assets*

Capital assets used in governmental and business-type activities include land and land improvements, buildings, structures and building improvements, machinery and equipment, furniture and fixtures, licensed vehicles, construction in progress, and infrastructure. These assets are capitalized and reported in the accompanying statement of net position. Infrastructure assets are generally stationary in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets.

For financial reporting purposes, the Municipality defines capital assets as assets with an individual cost of \$500 or more at the date of acquisition, construction or improvement, and with useful lives extending beyond one year. All assets with individual costs under \$500 or with useful lives not exceeding one year, are charged directly to expense in the government-wide statement of activities. In the governmental funds, all capital assets are recorded as capital outlays (expenditures).

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

In the statement of net position and the statement of net position – proprietary-fund, all capital assets are recorded at cost or estimated historical cost if actual cost was unavailable, except for donated capital assets, which are recorded at their estimated fair value at the date of donation. Estimated historical costs based on deflated current costs were used to value a significant portion of the infrastructure constructed or acquired prior to June 30, 2003 and certain lands, buildings, structures and building improvements. The method used to deflate the current costs with an approximate price index was used only in the case of certain items for which the historical cost documentation was not available. Actual historical costs were used to value the infrastructure acquired or constructed after June 30, 2003 as well as, construction in progress, machinery and equipment and licensed vehicles acquired prior or after such date.

Major outlays for capital assets and improvements are capitalized in the statement of net position as projects are constructed. The costs of normal maintenance and repairs that do not add value to the asset or materially extend capital asset lives are not capitalized.

Depreciation expense is recorded only in the government-wide statement of activities and the statements of revenues, expenses and changes in net position-proprietary fund. However, there is no depreciation or amortization recorded for land and construction in progress. Depreciable capital assets are generally depreciated or amortized over their estimated useful lives under the straight-line method, except for machinery and equipment held under capital leases which is depreciated over the shorter of its estimated useful life or the lease term.

The estimated useful lives of major capital asset categories are:

	<u>Years</u>
Land improvements	20
Buildings, structures and building improvements	30 to 60
Infrastructure	20 to 60
Motor vehicles	8
Furniture and fixtures	5 to 20
Machinery and equipment, excluding those held under capital leases	5 to 20
Machinery and equipment under capital leases	3 to 5

Depreciation expense of capital assets is recorded as a direct expense of the function/program specifically identified with the asset. Depreciation and amortization of infrastructure is not allocated to various functions/programs but reported as direct expenses of the urban and economic development function.

The Municipality periodically evaluates its capital assets to consider events or changes in circumstances that may give rise to asset impairment. Among the factors considered by management as part of its evaluation are physical damages to an asset where action would be needed to restore lost service utility, changes in laws, regulations, or other environmental factors that may negatively affect service utility, technological developments that may negatively affect service utility, changes in the manner or duration of use of a capital asset that may negatively affect its service utility, and stoppage of construction or development of an asset.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

**k) Other Assets**

Other assets in the proprietary fund consist principally of the tenant's security deposits and the statutory replacement reserve of the Las Flores Apartments project amounting to \$522,675. The resources held in the reserve are not liquid and readily available for operating purpose, and their use is limited to the acquisition, construction and improvement of the project's capital assets.

**l) Deferred Inflows of Resources**

In the GFFS, deferred inflows of resources arise when one of the following situations occur:

- Potential revenue does not meet both the "measurable" and "available" criteria for revenue recognition in the current period (unavailable revenue). As previously discussed, available is defined as due (or past due) at June 30, 2014 and collected within sixty (60) days for property taxes and ninety (90) days for all over revenue streams thereafter to pay obligations due at June 30. In subsequent periods, when both criteria are met, the liability for unearned revenue is removed and revenue is recognized.
- The Municipality receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criterion is met, the liability for unearned revenue is removed and revenue is recognized.

Deferred inflows of resources in the GWFS and the PFFS arise only when the Municipality receives resources before it has a legal claim to them.

**m) Compensated Absences**

Compensated absences are accounted for under the provisions of Statement No. 16, *Accounting for Compensated Absences*, issued by GASB (GASB No. 16). Compensated absences include paid time off made available to employees in connection with vacation, sick leave and compensatory time. The liability for compensated absences recorded in the accompanying statement of net position is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2014 and (2) is not contingent on a specific event that is outside the control of the Municipality and the employee (such as illness). Compensated absences that relate to future services or are contingent on a specific event outside the control of the employer or the employee are accounted for in the period when those services are rendered or those events take place.

The liability for compensated absences includes salary-related costs, which are directly and incrementally related to the amount of salary paid to the employee (such as employer's share of Social Security taxes and Medicare taxes).

The vacation policy of the Municipality provides for the accumulation of regular vacations at a rate of 2.5 days per month (30 days per year) per employee. Employees accumulate regular sick leave at a rate of 1.5 days per month (18 days per year). Employees accumulate compensatory time at a rate of 1.5 times the overtime worked. All vacation and sick leave days accumulated by employees in excess of 30 days and 90 days, respectively, are paid to employees each year, if not consumed, as required by law. In the case of compensatory time, the excess of 240 hours is paid to employees each year, if not consumed.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

Upon termination of employment, an employee receives compensation for all accumulated unpaid regular vacation leave at the current rate. In the case of regular sick leave, if the employee terminates his or her employment before reaching 10 years of services, such regular sick leave is not paid to the employee, if not consumed. In addition upon termination of employment, an employee does not receive compensation for compensatory time, if not consumed previously. After 10 years of services, any regular sick leave balance is paid to the employee. Accumulated vacation time is fully vested to the employee at any time.

The liability for compensated absences is reported in the statement of net position. A liability for compensated absences is reported in the GFFS only when matured (when payment is due), for example, as a result of employee resignations or retirements.

**n) Long-Term Obligations**

The long-term obligations reported in the accompanying statements of net position and the statement of fund net position-proprietary fund include the Municipality's bonds payable, mortgage notes payable, other notes payables and accrued compensated absences.

All long-term debt to be repaid from governmental resources is reported as liabilities in the accompanying statement of net position. Principal and interest payments on bonds due on July 1, 2014 are recorded as governmental fund liabilities in the GFFS (debt service fund) when resources are available in the debt service fund (June 30, 2014). In the GFFS, the face amount of debt issued (gross debt reported) is reported as other financing sources when issued.

**o) Accounting for Pension Costs**

For the purpose of applying the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers* (GASB No. 27), the state government of the Commonwealth of Puerto Rico is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto Rico and Its Instrumentalities (ERS) and System 2000, a multi-employer cost-sharing defined benefit pension plan and a hybrid defined contribution plan, respectively, in which the employees of the Municipality participate. The Municipality is considered a participant, and not a sponsor, of these retirement systems since the majority of the participants in the aforementioned pension trust funds are employees of the Commonwealth of Puerto Rico and the basic financial statements of such retirement systems are part of the financial reporting entity of the Commonwealth of Puerto Rico.

The Municipality accounts for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly, pension costs recognized in the accompanying basic financial statements are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions.

**p) Risk Management**

The Municipality carries commercial insurance covering casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Commonwealth's Department of Treasury (the Department of Treasury) on behalf of all municipalities of Puerto Rico. The Department of Treasury pays the insurance premiums on behalf of the Municipality and then is reimbursed each

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

year through monthly equal payments deducted from the Municipality's gross property tax collections made by the Municipal Revenue Collection Center ("CRIM", by its Spanish acronyms), a governmental entity responsible for billing and collecting property taxes on behalf of all municipalities of Puerto Rico.

The Municipality carries insurance coverage for death and bodily injuries caused by automobile accidents. This insurance is obtained through the Automobile Accidents Compensation Administration (ACAA), a component unit of the Commonwealth. This insurance is compulsory for all licensed vehicles used on public roads and highways in Puerto Rico. The annual premium is \$35 per licensed motor vehicle, which is paid directly to ACAA.

The Municipality obtains workers' compensation insurance coverage through the State Insurance Fund Corporation (SIFC), a component unit of the Commonwealth. This insurance covers workers against injuries, disability or death because of work or employment-related accidents, or because of illness suffered as a consequence of their employment. Workers' compensation insurance premiums are also paid through monthly deductions made by CRIM from the Municipality's gross property tax collections.

The Municipality obtains unemployment compensation, non-occupational disability, and drivers' insurance coverage for its employees through various insurance programs administered by the Commonwealth's Department of Labor and Human Resources (DOL). These insurance programs cover workers against unemployment and provide supplementary insurance coverage for temporary disability, or death because of work or employment-related accidents or because of illness suffered as a consequence of their employment. Unemployment compensation, non-occupational disability and drivers' insurance premiums are paid directly to DOL on a cost reimbursement basis.

The Municipality also obtains medical insurance coverage from several health insurance companies for its employees. Different health insurance coverage and premium options are negotiated each year by the Department of Treasury on behalf of the Municipality. The current insurance policies have not been canceled or terminated at June 30, 2014. Premiums are paid on a monthly basis directly to the insurance company. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

**q) Fund Balances**

On July 1, 2010, the Municipality adopted the provisions of GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB 54), which enhanced the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied. This statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which the Municipality is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

Fund balances in the accompanying basic financial statements have been reported as assigned, restricted or unassigned, based on the relative strength of the constraints that control how specific amounts can be spent, as described as follows:

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

- a. *Assigned* – Represent net resources recorded in the general fund intended to be used by the Municipality for specific purposes but do not meet the criteria to be classified as restricted or committed (generally budgetary encumbrances or executive orders approved by the Mayor). The Municipal Legislature delegates the Mayor the authority to establish fund balance assignments.

At June 30, 2014 assigned fund balances in the general fund consist of fund balances reserved for encumbrances amounting to \$578,228.

- b. *Restricted* – Represent net resources that can be spent only for the specific purposes stipulated by constitutional provisions, external resource providers (externally imposed by creditors or grantors), or through enabling legislation (that is, legislation that creates a new revenue source and restricts its use). Effectively, restrictions may be changed or lifted only with the consent of resource providers. In the accompanying basic financial statements, restricted fund balances have been reported in the following funds and for the following purposes:
- *Capital improvements bond fund* – restricted fund balance consist of financial resources to be used only for the acquisition, construction or improvement of capital assets under contracts and other commitments, as approved and financed by the Government Development Bank for Puerto Rico.
  - *Legislative joint resolutions fund* – restricted fund balance consist of financial resources arising from grants and contributions received through resolutions of the Legislature of the Commonwealth of Puerto Rico to be used principally for the acquisition, construction or improvement of capital assets under contracts and other commitments.
  - *Debt service fund* – restricted fund balance consist of financial resources available only to cover future debt service payments (principal and interest) on bonds and notes payable, which are accounted for in the debt service fund, as required by Law.
  - *Other governmental funds* – restricted fund balance consist of financial resources arising from operating and capital grants and contributions from state and federal grantors that can be spent only for the specific purposes stipulated by the respective external resource providers, or through enabling legislation.
- c. *Unassigned* – Represent the residual classification for the Municipality's general fund and includes all spendable amounts not contained in the other classifications.

The Municipality had no fund balances classified as *committed* at June 30, 2014. Those types of fund balances are generally related to financial resources used for specific purposes, imposed by formal action of the Municipality's highest level of decision making authority (Municipal Legislature through resolutions and ordinances), which would only be changed by a similar law, ordinance or resolution.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

The Municipality reports resources constrained to stabilization as a specified purpose (restricted or committed fund balance in the general fund) only if: (1) such resources meet the other criteria for those classifications, as described above and (2) the circumstances or conditions that signal the need for stabilization are identified in sufficient detail and are not expected to occur routinely. However, the Municipality has not entered into any stabilization-like arrangements, nor has set aside material financial resources for emergencies and has not established formal minimum fund balance amounts as of and for the fiscal year ended June 30, 2014.

In situations when expenditure is made for a purpose for which amounts are available in multiple fund balance classifications, the Municipality uses restricted resources first, and then unrestricted resources. Within unrestricted resources, the Municipality generally spends committed resources first, followed by assigned resources, and then unassigned resources when expenditures.

The classification of the Municipality's individual funds among general, debt service, special revenue, capital projects and proprietary fund types used in prior fiscal years for financial reporting purposes was not affected by the implementation of GASB 54. In addition, the financial positions and the results of operations reported in the accompanying GFFS as of and for the fiscal year ended June 30, 2014 have not been affected for this change in accounting principle. Accordingly, the accompanying GFFS have not reported any retroactive restatements or reclassifications of fund equities as of July 1, 2013.

*r) Inter-fund Activities*

The Municipality has the following types of reciprocal and non-reciprocal inter-fund activities recorded among governmental funds in the accompanying GFFS:

- *Inter-fund loans* – Represent amounts provided with a requirement for repayment, which are recorded as “due from” in the lender governmental fund and “due to” in the borrower governmental fund. Inter-fund receivables, which are not considered to be currently available financial resources, are reported as advances. For amounts not expected to be collected within a reasonable period of time, inter-fund receivables/payables are reduced to the estimated realizable value and the amount that is not expected to be repaid is reported as an operating transfer from the governmental fund that made the loan.
- *Inter-fund transfers* – Represent flows of assets (permanent reallocation of financial resources among governmental funds) without equivalent flows of assets in return and without a requirement for repayment. Operating transfers are reported as other financing sources in the governmental fund making transfers and as other financing sources in the governmental fund receiving transfers.
- *Inter-fund reimbursements* – Represent repayments from the governmental fund responsible for particular expenditures or expenses to the governmental fund that initially paid for them.

In the GFFS, inter-fund activity has not been eliminated, as permitted by GAAP.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

*s) Use of Estimates*

The preparation of the accompanying basic financial statements in conformity with GAAP requires management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the basic financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

*t) Accounting Standards Issued But Not Yet Adopted*

The Governmental Accounting Standards Boards has issued the following standards that have not been adopted by the Municipality, and are currently under evaluation for their impact in future financial statements:

- a. GASB Statement No. 68 (GASB 68), *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27* was issued in June 2012. The provisions of GASB 68 are effective for financial statements for fiscal years beginning after June 15, 2014.
- b. GASB Statement No. 69 (GASB 69), *Government Combinations and Disposals of Government Operations*, was issued in January 2013. *Government Combinations and Disposals of Government Operations*, was issued in January 2013. The requirements of GASB 69 are effective for government combinations and disposals of government operations occurring in financial reporting periods beginning after December 15, 2013, and should be applied on a prospective basis.
- c. GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date, an Amendment of GASB Statement No. 68*. The provisions of GASB 68 are effective for financial statements for fiscal years beginning after June 15, 2014.

The Municipality is currently evaluating the effect of the adoption of the aforementioned accounting standards in the Municipality's financial statements to be issued in future fiscal years.

*u) Reclassifications*

Certain reclassifications have been made to the 2013 figures reported in the accompanying management's discussion and analysis to conform them with their respective 2014 presentation.

**2. Deposits**

The Municipality maintains its deposits in various commercial banks located in Puerto Rico and the Government Development Bank for Puerto Rico (GDB), fiscal agent. Proceeds from all bonds and notes payable, and the funds related to certain federal grant awards are required by law to be held with GDB, as fiscal agent.

On July 1, 2004, the Municipality adopted the provisions of GASB Statement No. 40 (GASB No. 40), *Deposit and Investment Risk Disclosure, an Amendment to GASB Statement No. 3*. This statement requires that state and local governments disclose essential risk information about deposits and

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

investments. The disclosure requirements cover four main areas: (1) credit risk, (2) interest rate risk, (3) custodial credit risk, and (4) foreign exchange exposure.

- **Credit risk** – This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. In compliance with the laws and regulations of the Commonwealth of Puerto Rico, the Municipality has adopted, as its custodial credit risk policy, the *Statement of Uniform Investment Guidelines for the Municipalities of the Commonwealth of Puerto Rico*, issued by the Government Development Bank for Puerto Rico as promulgated by Law No. 113 of August 3, 1995. Accordingly, the Municipality is only allowed to invest in obligations of the Commonwealth of Puerto Rico, obligations of the United States of America, certificates of deposit, commercial paper, bankers' acceptances or in pools of obligations of the Municipalities of Puerto Rico, which are managed by GDB. According to the aforementioned investment guidelines, the Municipality is not allowed to invest in marketable securities or any other type of investments (debt securities) for which credit risk exposure may be significant. Therefore, the Municipality's management has concluded that the credit risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2014.
- **Interest rate risk** – This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality has no formal policy relating to interest rate risks, however, the Municipality manages its exposure to declines in fair values by: (1) not including debt or equity investments in its investments portfolio at June 30, 2014, (2) keeping most of its banks deposits and certificates of deposit in interest bearing accounts generating interest at prevailing market rates. At June 30, 2014, the interest rate risk associated with the Municipality's cash is considered low since the investment portfolio of the Municipality do not include debt securities or any type of investments that could be affected by changes in interest rates.
- **Custodial credit risk** – In the case of deposits, this is the risk that in the event of a bank failure, the Municipality's deposits may not be recovered. Pursuant to the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*, the balances deposited in commercial banks by the Municipality are insured by the Federal Deposit Insurance Corporation (FDIC), generally up to a maximum of \$250,000 per depositor. In addition, public funds deposited in commercial banks by the Municipality are fully collateralized for the amounts deposited in excess of the federal depository insurance. All securities pledged as collateral are held in the Municipality's name by the agents of the Commonwealth's Secretary of Treasury. Deposits in GDB, amounting to \$8,373,020 at June 30, 2014, are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2014. It is management's policy to only maintain deposits in banks affiliated to FDIC to minimize the custodial credit risk, except for GDB. Therefore, the Municipality's management has concluded that at June 30, 2014, the custodial credit risk associated with the Municipality's cash is considered low.
- **Foreign exchange risk** – This is the risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, adopted by the Municipality, the Municipality is prevented from investing in foreign securities or any other types of investments for which foreign exchange risk exposure may be

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

significant. Accordingly, management has concluded that the foreign exchange risk related to the Municipality's deposits is considered low at June 30, 2014.

Cash in commercial banks and fiscal agent at June 30, 2014, are classified in the accompanying balance sheet – governmental and proprietary funds a follows:

	Major governmental funds						Proprietary fund
	General fund	Capital projects fund	Legislative joint resolutions fund	Debt service fund	Other governmental funds	Total governmental funds	
Unrestricted:							
Cash in commercial banks	\$ 1,771,501	-	-	-	-	\$ 1,771,501	\$ -
Restricted:							
Cash in commercial banks	-	204,188	487,397	-	1,387,942	2,079,527	72,675
Cash in fiscal agent	-	4,641,707	-	3,269,462	461,851	8,373,020	-
Total carrying amount of deposits	<u>\$ 1,771,501</u>	<u>4,845,895</u>	<u>487,397</u>	<u>3,269,462</u>	<u>1,849,793</u>	<u>\$ 12,224,048</u>	<u>\$ 72,675</u>

### 3. Municipal License Taxes

The Municipality is authorized by Act No. 81 to impose and collect municipal license taxes to any natural or legal person having trade or business activities within the territory of Aibonito. This is a self-assessed tax generally based on the business volume of taxpayers, measured by gross revenues. The Municipality establishes the applicable tax rates. At June 30, 2014, the municipal license tax rates imposed by the Municipality were 1.50 percent for financial institutions and 0.50 percent for other types of taxpayers. Any taxpayers that have been granted with a partial tax exemption under any of the tax incentive acts of the Commonwealth ultimately pay municipal license taxes at reduced tax rates, generally between 60 percent and 90 percent under standard rates.

Each taxpayer must assess the corresponding municipal license tax by declaring the volume of business through a tax return to be filed every April 15, based on the actual volume of business (revenues) generated in the preceding calendar year. Taxpayers with a sales volume of \$3 million or more must include audited financial statements with their tax return filings. The tax can be paid by the taxpayer in two equal installments due on July 15 and January 15, subsequent to the filing of the declaration on April 15. The first installment of the tax covers the six-month period ended December 31, subsequent to the filing date of the declaration, while the second installment of the tax covers the six-month period ended June 30 of the subsequent calendar year. If a taxpayer elects to pay the tax in full on the filing date of the declaration (generally April 15), a 5 percent discount is granted automatically on the total tax amount due.

Any municipal license taxes collected in advance (that is, pertaining to a future fiscal year) are recorded as deferred inflows of resources in the GWFS and the GFFS. Deferred inflows of resources related to municipal license tax revenues recorded in the accompanying GWFS and GFFS amounted to \$1,468,544 at June 30, 2014.

Municipal license taxes receivable recorded in the general fund amounted to \$12,381 at June 30, 2014. Municipal license tax revenues amounted to \$1,918,314 for the fiscal year then ended, which has been recorded in the general fund since is available for general operating purposes.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

**4. Property Taxes**

The Municipality is authorized by Act No. 81 to impose and collect property taxes from any natural or legal person that, at January 1 of each calendar year: (1) is engaged in trade or business and is the owner of personal or real property used in trade or business or (2) owns residential real property with a value in excess of \$15,000 (at 1957 market prices).

Personal property taxes are self-assessed by taxpayers every year using the book value of personal property assets owned by the taxpayer at January 1 (lien; levy date) and reporting such taxable value through a personal property tax return filed on May 15 (due date and collection date) subsequent to the assessment date. The total personal property tax rate in force at June 30, 2014 was 6.28 percent (of which taxpayers pay 6.08 percent and the remaining 0.20 percent is paid by the Department of Treasury, as a subsidy).

Real property taxes are assessed every January 1, (lien; levy date) and is based on estimated current values of the property, deflated to 1957 market prices. Real property taxes are due and collectible on January 1 and July of every fiscal year. The total real property tax rate in force at June 30, 2014 was 8.28 percent (of which 8.08 percent is paid by taxpayers and the remaining 0.20 percent is also paid by the Department of Treasury, as a subsidy).

Residential real property occupied by its owner (not engaged in trade or business) is exempt from property taxes only on the first \$15,000 of the assessed value (at 1957 market prices). For exempt amounts, the Department of Treasury assumes the payment of the basic tax (4.00 percent and 6.00 percent for personal and real property, respectively), except for property assessed for less than \$3,500 (at 1957 market prices), for which no payment is made by the Department of Treasury.

Included within the total personal and real property tax rates of 6.28 percent and 8.28 percent, respectively, there is a portion of the tax rate in the amount of 1.05 percent that is restricted for the Municipality's debt service requirements on bonds. Such amounts are recorded in the Municipality's debt service fund.

The composition of property taxes receivable is as follows at June 30, 2014:

	<b>Major governmental funds</b>		<b>Total</b>
	<b>General fund</b>	<b>Debt service fund</b>	
Property taxes receivable	\$ 1,070,340	5,337	\$ 1,075,677

Property tax revenues recorded in the general fund and the debt service fund amounted to \$1,887,317 and \$537,908, respectively, for the fiscal year ended June 30, 2014.

**5. Sales and Use Taxes**

The Municipality imposes a municipal sales and use tax within the territorial limits of the Municipality. This is a self-assessed tax applied to the sale price of a taxable item or on the purchase

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

price of all usage, storage or consumption of a taxable item. It is collected on a monthly basis through a tax return that is due ten calendar days after the end of each month. The municipal sales and usage tax rate was one point five percent (1.5%) until June 30, 2014.

A portion of the sales tax amounting to zero point two percent (0.2%) is imposed and collected by the Puerto Rico Treasury Department on behalf of the Municipality, is restricted for the payment of long-term debt and is recorded in the debt service fund as intergovernmental grants and contributions. The remaining portion of one point three percent (1.3%) is recorded in the general fund since it was available for general operating purposes.

Sales and use taxes receivable recorded in the general fund amounted to \$49,306 at June 30, 2014. Sales and use taxes revenues recorded in the general fund amounted to \$641,305 for the fiscal year then ended.

**6. Construction Excise Taxes**

The Municipality imposes and collects municipal construction excise taxes to most natural and legal persons and any governmental instrumentality that carry out activities related to construction, expansion, major repairs, relocations, alterations and other types of permanent improvements to residential, commercial and industrial buildings and structures within the territorial area of the Municipality. The tax is also applicable to infrastructure projects, the installation of machinery, equipment and fixtures, and other types of construction-related activities.

The construction excise tax generally is a self-assessed tax imposed over the cost of the project, net of certain exemptions such as the costs associated with the acquisition of land, project design and other engineering fees, licenses and permits, legal and accounting fees, and most marketing and advertising costs. The tax is paid by the taxpayer at the beginning of the project.

All single-family residential construction projects not related to housing development projects, condominiums, or any similar projects, are partially exempt from construction excise taxes. In addition, a portion of all single-family residential improvement projects are exempt from construction excise taxes. All projects carried out on buildings and structures classified as historical treasures by the Puerto Rico Planning Board have an in the tax rate applicable to construction excise taxes.

Construction excise taxes receivable recorded in the general fund amounted to \$39,326 at June 30, 2014. Construction excise tax revenues amounted to \$404,867 for the fiscal year then ended which has been recorded in the general fund since is available for general operating purposes.

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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

**7. Intergovernmental Receivables and Payables**

Intergovernmental receivables and payables recorded in the accompanying GWFS and GFFS are as follows at June 30, 2014:

	<u>Major governmental funds</u>			Other governmental funds	Total
	General fund	Capital improvements bond fund	Debt service fund		
<b>Intergovernmental receivables:</b>					
<i>Intergovernmental grants and contributions:</i>					
Puerto Rico Treasury Department -					
Employees' Christmas bonus cost reimbursement	\$ 61,168	-	-	-	\$ 61,168
Rural development program fund	-	12,944	-	-	12,944
Government Development Bank for Puerto Rico -					
Special Communities fund	-	-	-	1,151,679	1,151,679
Puerto Rico Department of Labor and Human					
Resources - Department of Labor fund	-	-	-	132,064	132,064
U.S. Department of Housing and Urban Development:					
SBGP Block Grant	-	164,159	-	-	164,159
Miscellaneous special revenue fund	-	-	-	4,828	4,828
U.S. Department of Justice - COC Program	-	-	-	350	350
Puerto Rico Electric Power Authority -					
contribution in lieu of municipal taxes	1,134,688	-	-	-	1,134,688
Commonwealth of Puerto Rico - contribution from the					
state-collected sales and usage taxes	-	-	214,548	-	214,548
Total intergovernmental receivables	<u>\$1,195,856</u>	<u>177,103</u>	<u>214,548</u>	<u>1,288,921</u>	<u>\$ 2,876,428</u>
<b>Intergovernmental payables:</b>					
<i>Utilities and charges for services:</i>					
Puerto Rico Electric Power Authority - Electric power					
consumption costs	\$1,134,688	-	-	-	\$ 1,134,688
Puerto Rico Sewer and Water Authority - Sewer and					
water consumption costs	38,360	-	-	-	38,360
Total intergovernmental payables	<u>\$1,173,048</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>\$ 1,173,048</u>

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COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

**8. Inter-fund Transactions**

The composition of all inter-fund balances and transactions at June 30, 2014 and for the fiscal year then ended is as follows:

Due to other governmental funds	Due from other governmental funds			Total governmental funds
	General fund	Legislative joint resolutions fund	Other governmental funds	
<i>Major governmental funds:</i>				
General fund	\$ -	826,803	502	\$ 827,305
Capital improvements bond fund	1,503,873	-	-	1,503,873
Debt service fund	40	-	-	40
Other governmental funds	96,261	-	-	96,261
Total	\$ 1,600,174	826,803	502	\$ 2,427,479

Transfers to other governmental funds	Transfers from other governmental funds			Total governmental funds
	General fund	Capital improvements bond fund	Other governmental funds	
<i>Major governmental funds:</i>				
General fund	\$ -	47	63,552	\$ 63,599
Capital improvements bond fund	190,432	-	-	190,432
Debt service fund	591	-	-	591
Other governmental funds	63,745	247	-	63,992
Total	\$ 254,768	294	63,552	\$ 318,614

The principal purposes of interfund receivables and payables among governmental funds are:

- Recognize the outstanding balance of loans amounting to \$1,503,873 granted by the general fund to the capital improvements bond fund to finance the costs of the acquisition, construction and improvement of various major capital assets.
- Recognize the outstanding balance of loans amounting to \$826,803 granted by the legislative joint resolutions fund to the general fund for liquidity and working capital purpose.
- Recognized in the general fund the outstanding balance of \$96,261 of loans granted to other governmental funds to finance the operation of various programs.

The principal purposes of inter-fund transfers among governmental funds are:

- Make a non-routine residual equity transfer amounting to \$63,552 from the COPS fund, a non-major special revenue fund, to the general fund.
- Make a non-routine contribution of \$63,552 from the general fund to the COPS fund for liquidity and working capital purpose.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

- Make a routinary transfer of interest income amounting to \$190,432 from the capital improvements bond fund to the general fund, as permitted by law. This interest income was earned by the deposits held in the capital improvements bond fund and was transferred to the general fund.

**9. Capital Assets**

Capital assets activity for the fiscal year ended June 30, 2014:

	Balance at beginning of fiscal year, as restated	Additions/ depreciation expense	Balance at end of fiscal year
<b><u>Governmental activities:</u></b>			
<i>Cost basis:</i>			
Capital assets, not being depreciated -			
Land	\$ 15,812,537	-	\$ 15,812,537
Capital assets, being depreciated:			
Buildings, structures, and improvements	18,887,706	2,847,032	21,734,738
Infrastructure	12,032,223	285,389	12,317,612
Machinery and equipment, and furniture and fixtures	624,330	46,212	670,542
Licensed vehicles	2,697,276	-	2,697,276
Total capital assets, being depreciated	34,241,535	3,178,633	37,420,168
Total cost basis of capital assets	50,054,072	3,178,633	53,232,705
<i>Accumulated depreciation:</i>			
Buildings, structures, and improvements	5,368,959	797,302	6,166,261
Infrastructure	6,621,569	208,622	6,830,191
Machinery and equipment, and furniture and fixtures	382,912	63,207	446,119
Licensed vehicles	2,210,558	99,591	2,310,149
Total accumulated depreciation	14,583,998	1,168,722	15,752,720
Net capital assets	\$ 35,470,074	2,009,911	\$ 37,479,985

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COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

Depreciation expense of governmental activities was charged to functions in the accompanying government -wide statement of activities as follows for the fiscal year ended June 30, 2014:

General government	\$	83,271
Urban and economic development		408,404
Public safety		12,976
Public housing and welfare		97,614
Culture, recreation and education		566,457
Total depreciation expenses		\$ 1,168,722

	Balance at beginning of fiscal year	Additions/ depreciation expense	Balance at end of fiscal year
<b><u>Business-type activities:</u></b>			
<i>Cost basis:</i>			
Capital assets, not being depreciated - land	\$ 126,150	-	\$ 126,150
Capital assets, being depreciated:			
Buildings, structures, and improvements	4,289,014	-	4,289,014
Land improvements	267,559	5,000	272,559
Machinery and equipment, and furniture and fixtures	418,922	52,539	471,461
Total capital assets, being depreciated	4,975,495	57,539	5,033,034
Total cost basis of capital assets	5,101,645	57,539	5,159,184
<i>Accumulated depreciation:</i>			
Buildings, structures, and improvements	3,057,488	179,016	3,236,504
Land improvements	209,336	11,357	220,693
Machinery and equipment, and furniture and fixtures	214,869	20,832	235,701
Total accumulated depreciation	3,481,693	211,205	3,692,898
Net capital assets	\$ 1,619,952	(153,666)	\$ 1,466,286

Depreciation expense of business-type activities, amounting to \$211,205 for the fiscal year ended June 30, 2014, was charged to the public housing and welfare function in the accompanying statement of activities.

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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

**10. Deferred Inflows of Resources**

At June 30, 2014, deferred inflows of resources recorded in the GWFS and the GFFS are as follows:

	<u>Major governmental funds</u>			<u>Total governmental funds</u>	<u>Statement of net position</u>
	<u>General fund</u>	<u>Capital improvements bond fund</u>	<u>Other governmental funds</u>		
<i>Unavailable revenues</i> - intergovernmental grants and contributions	\$ 61,168	-	-	61,168	\$ -
<i>Unearned revenues:</i>					
Municipal license taxes	1,468,544	-	-	1,468,544	1,468,544
Intergovernmental grants and contributions	-	869	753,994	754,863	754,863
Total unearned revenues	<u>1,468,544</u>	<u>869</u>	<u>753,994</u>	<u>2,223,407</u>	<u>2,223,407</u>
Total deferred inflows of resources	<u>\$ 1,529,712</u>	<u>869</u>	<u>753,994</u>	<u>2,284,575</u>	<u>\$ 2,223,407</u>

**11. Long-Term Obligations**

The general long-term obligations activity for the fiscal year ended June 30, 2014 is as follows:

	<u>Balance at beginning of fiscal year</u>	<u>Borrowings or additions</u>	<u>Payments or deductions</u>	<u>Balance at end of fiscal year</u>	<u>Balance due within one year</u>
<i>Governmental activities:</i>					
<u>Bonds payable - general obligation serial bonds</u>	\$ 12,849,610	-	(533,500)	12,316,110	\$ 485,000
<u>Notes payable:</u>					
Municipal Revenue Collection Center - (CRIM):					
Law No. 146 of October 11, 2001	106,607	-	-	106,607	106,607
<u>Compensated absences</u>	706,137	1,387,160	(610,751)	1,482,546	610,751
Total governmental activities	<u>\$ 13,662,354</u>	<u>1,387,160</u>	<u>(1,144,251)</u>	<u>13,905,263</u>	<u>\$ 1,202,358</u>
<i>Business-type activities:</i>					
<u>Mortgage notes payable - Mortgage loan</u>	\$ 687,727	-	(99,935)	587,792	\$ 108,067
Total business-type activities	<u>\$ 687,727</u>	<u>-</u>	<u>(99,935)</u>	<u>587,792</u>	<u>\$ 108,067</u>

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COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

Historically, the general fund has been used to liquidate the notes payable to CRIM, compensated absences, and any other long-term liabilities other than bonds.

*a) Debt Limitation*

The Municipal Legislature is legally authorized to approve the contracting of debts of the Municipality. Nevertheless, the laws and regulations of the Commonwealth of Puerto Rico also provide that:

- Direct obligations of the Municipality (evidenced principally by bonds and bond anticipation notes) are backed by the full faith, credit and taxing power of the Municipality; and
- Direct obligations are not to be issued by the Municipality if the amount of the principal of, and the interest on, such bonds and bond anticipation notes (and on all bonds and notes issued thereafter) which are payable in any fiscal year, together with any amount paid by the Municipality in the preceding fiscal year on account of bonds or bond anticipation notes guaranteed by the Municipality, exceed 10 percent of the total assessed value of the property located within the Municipality plus the balance of the ad valorem taxes in the debt service fund, for bonds payable and bond anticipation notes to be repaid with the proceeds of property taxes restricted for debt service.

In addition, before any new bonds are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirements. The Municipality's available legal debt margin amounted to \$5.6 million at June 30, 2014, as determined by GDB.

*b) Bonds Payable*

The Municipality issues general obligation, special obligation and public improvement bonds to finance the acquisition, construction and improvement of capital assets, as well as, to finance certain operating needs, including the payment to suppliers in certain circumstances.

The laws and regulations of the Commonwealth of Puerto Rico provide that the Municipality's public debt will constitute a first claim on the available revenue of the Municipality. Public debt includes bonds and bond anticipation notes. The good faith, credit and taxing power of the Municipality are irrevocably pledged for the prompt payment of the principal and interest of bonds.

As described in Note 4, the Municipality levies an annual additional special property tax of 1.05 percent of the assessed value of personal and real property. The proceeds of this additional special tax are deposited in a sinking fund established at GDB whereby sufficient funds are set aside to redeem the bonds payable of the Municipality in minimum annual or semiannual principal and interest payments. The collections of this special tax are recorded in the Municipality's debt service fund.

For financial reporting purposes, the outstanding balances of bonds represent the total principal to be repaid. Bonds payable is composed as follows at June 30, 2014:

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

	<u>Outstanding amount</u>
Municipal general obligation bond series 1991-1992 for the construction, improvements and acquisition of various capital assets (face amount of \$572,000), due in annual principal installments ranging from \$14,000 to \$41,000; plus interest at 5.00% through July, 1, 2016.	\$ 79,000
Municipal general obligation bond series 1995-1996 for the construction, improvements and acquisition of various capital assets (face amount of \$1,040,000), due in annual principal installments ranging from \$15,000 to \$90,000; plus interest at variable rates (6.58% at June 30, 2014) through July, 1, 2020.	515,000
Municipal general obligation bond series 1995-1996 for the construction, improvements and acquisition of various capital assets (face amount of \$332,000), due in annual principal installments ranging from \$6,000 to \$20,000; plus interest at variable rates (4.50% at June 30, 2014) through July 1, 2028.	229,000
Municipal general obligation bond series 2001-2002 for the construction, improvements and acquisition of various capital assets (face amount \$575,000), due in annual principal installments ranging from \$10,000 to \$50,000; plus interest at variable rates (4.73% at June 30, 2014) through July, 1, 2026.	425,000
Municipal general obligation bond series 2002-2003 for the construction, improvements and acquisition of various capital assets (face amount \$310,000), due in annual principal installments ranging from \$5,000 to \$10,000; plus interest at variable rates (4.45% at June 30, 2014) through July 1, 2027.	230,000
Municipal general obligation bond series 2004-2005 for the construction, improvements and acquisition of various capital assets (face amount of \$465,000), due in annual principal installments ranging from \$10,000 to \$35,000; plus interest at variable rates (4.45% at June 30, 2014) through July 1, 2029.	360,000
Municipal general obligation bond series 2005-2006 for the construction, improvements and acquisition of various capital assets (face amount of \$485,000), due in annual principal installments ranging from \$5,000 to \$35,000; plus interest at variable rates (4.45% at June 30, 2014) through July 1, 2030.	405,000
Municipal general obligation bond series 2007-2008 for the construction, improvements and acquisition of various capital assets (face amount of \$800,000), due in annual principal installments ranging from \$25,000 to \$85,000; plus interest at variable rates (7.50% at June 30, 2014) through July 1, 2022.	585,000

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

	<u>Outstanding amount</u>
Municipal general obligation bond series 2006-2007 for the construction, improvements and acquisition of various capital assets (face amount of \$380,000), due in annual principal installments ranging from \$5,000 to \$35,000; plus interest at variable rates (7.50% at June 30, 2014) through July 1, 2032.	\$ 345,000
Municipal general obligation bond series 2005-2006 for the construction, improvements and acquisition of various capital assets (face amount of \$190,000), due in annual principal installments ranging from \$5,000 to \$20,000; plus interest at variable rates (7.00% at June 30, 2014) through July 1, 2021.	125,000
Municipal general obligation note series 2007-2008 for the construction, improvements and acquisition of various capital assets (face amount of \$2,965,000), due in annual principal installments ranging from \$60,000 to \$265,000; plus interest at variable rates (7.50% at June 30, 2014 through July 1, 2029.	2,610,000
Municipal general obligation bond series 2010-2011 for the construction, improvements and acquisition of various capital assets (face amount of \$1,435,000), due in annual principal installments ranging from \$5,000 to \$20,000; plus interest at variable rates (6.00% at June 30, 2014) through July 1, 2031.	1,340,000
Municipal general obligation bond series 2010-2011 for the construction, improvements and acquisition of various capital assets (face amount of \$2,710,000), due in annual principal installments ranging from \$5,000 to \$20,000; plus interest at variable rates (6.00% at June 30, 2014) through July 1, 2021.	2,580,000
Municipal general obligation bond series 2010-2011 for the construction, improvements and acquisition of various capital assets (face amount of \$705,000), due in annual principal installments ranging from \$5,000 to \$20,000; plus interest at variable rates (6.00% at June 30, 2014) through July 1, 2021.	540,000
Municipal general obligation bond series 2010-2011 for the construction, improvements and acquisition of various capital assets (face amount of \$440,000), due in annual principal installments ranging from \$50,000 to \$80,000; plus interest at variable rates (7.50% at June 30, 2014) through July 1, 2017.	275,000
Municipal general obligation bond series 2011-2012 for the construction, improvements and acquisition of various capital assets (face amount of \$166,110), due in annual principal installments ranging from \$4,200 to \$10,510; plus interest at variable rates (4.00% at June 30, 2014) through January 1, 2035.	153,110

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

	<b>Outstanding amount</b>
Municipal general obligation bond series 2012-2013 for the construction, improvements and acquisition of various capital assets (face amount of \$475,000), due in annual principal installments ranging from \$5,000 to \$40,000; plus interest at variable rates (6.00% at June 30, 2014) through July 1, 2037.	\$ 470,000
Municipal general obligation bond series 2012-2013 for the construction, improvements and acquisition of various capital assets (face amount of \$1,060,000), due in annual principal installments ranging from \$10,000 to \$85,000; plus interest at variable rates (6.00% at June 30, 2014) through July 1, 2037.	1,050,000
<b>Total bonds payable</b>	<b>\$ 12,316,110</b>

Variable interest rates on serial bonds are reviewed periodically by GDB and are based on the fluctuation of GDB's weighted average rate for its commercial paper program. Under this program, GDB issues commercial paper: (1) in the taxable and tax-exempt markets of the United States of America, (2) in the Eurodollar market, and (3) to corporations having tax exemptions under the Industrial Incentives Acts of the Commonwealth of Puerto Rico and, which qualify for benefits provided by the U.S. Internal Revenue Code.

Annual debt service requirements of maturity for bonds payable are as follows:

<b>Fiscal year ending June 30,</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2015	\$ 485,000	753,729	\$ 1,238,729
2016	604,000	767,362	1,371,362
2017	603,200	726,216	1,329,416
2018	649,400	689,717	1,339,117
2019	628,640	667,668	1,296,308
2020-2024	3,174,260	2,806,807	5,981,067
2025-2029	2,528,020	1,532,404	4,060,424
2030-2034	2,263,900	734,611	2,998,511
2035-2038	1,379,690	189,711	1,569,401
<b>Totals</b>	<b>\$ 12,316,110</b>	<b>8,868,225</b>	<b>\$ 21,184,335</b>

At June 30, 2014, accrued interest payable on bonds amounted to \$292,789. Interest expense paid on bonds amounted to \$583,896 for the fiscal year ended June 30, 2014.

According to sections 103 and 148 to 150 of the U.S. Internal Revenue Code and sections 1.148 to 1.150 of the U.S. Treasury Regulation, the Municipality's tax-exempt bonds are subject to the arbitrage rebate requirements. At June 30, 2014, the Municipality had no federal arbitrage

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

liability on bonds since interest income earned from the investment of unspent bond proceeds were made in bank deposits that generate yields lower than the rates applicable to the debt service payments.

c) *Notes Payable to CRIM - Law No. 146* – On September 24, 2002, CRIM, on behalf of the municipalities of Puerto Rico, entered into a financing agreement with GDB pursuant to the provisions of Law No. 146 of October 11, 2001, as amended (Law No. 146). The purpose of this financing agreement was to extinguish in advance, certain bonds payable issued by Public Finance Corporation (PFC), a subsidiary of the Government Development Bank for Puerto Rico, which were originally issued to pay certain property tax receivables owned by the municipalities of Puerto Rico through 1996, which were acquired by PFC with recourse. The outstanding principal of the notes amounted to \$106,607 at June 30, 2014, which is due in full during the fiscal year ending June 30, 2015. No principal and interest maturities were due during the fiscal year ended June 30, 2014.

d) *Mortgage Notes Payable – Proprietary Fund*

The long-term debt of Las Flores Apartments (FmHA and HUD Project No. 63-005-660-43-3572), a proprietary fund, consists of mortgage notes payable, secured by a first mortgage on the real property of the apartments. The notes are payable in monthly installments of \$11,654 plus interest at 8.00 percent per annum. At June 30, 2014, the outstanding balance of the mortgage note payable amounted to \$587,792.

Interest expense on these mortgage notes payable amounted to \$39,918 for the fiscal year ended June 30, 2014.

Annual debt service requirements of maturities of these mortgage notes are as follows:

Fiscal year ending June 30,	Principal	Interest	Total
2015	\$108,067	43,047	\$151,114
2016	117,037	34,078	151,115
2017	126,751	24,364	151,115
2018	137,271	13,844	151,115
2019	98,666	2,956	101,622
Totals	\$587,792	118,289	\$706,081

12. Employees' Retirement Systems

a) *Cost-Sharing Multiple-Employer Defined Benefit Pension Plan*

The Municipality's employees participate in the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS), a cost-sharing multi-employer (as related to the Municipality's reporting entity) defined benefit pension plan established by the Commonwealth and administered by the Retirement Systems Administration of the Commonwealth of Puerto Rico. Substantially all full-time employees of the Commonwealth

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

and substantially all municipalities are covered by ERS under the terms of Public Act No. 447 of May 15, 1951, as amended (Act No. 447). All regular and temporary employees of the Municipality become plan members of ERS at the date of employment, while it is optional for officers appointed. ERS members, other than those joining it after March 31, 1990, are eligible for the benefits described below:

***Retirement Annuity***

ERS members are eligible for a retirement annuity upon reaching the following age:

<b>Policemen and firemen:</b>	<b>Other employees:</b>
50 with 25 years of credited service	55 with 25 years of credited service
58 with 10 years of credited service	58 with 10 years of credited service

ERS members are eligible for monthly benefit payments determined by the application of the stipulated benefit ratios to the member's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by ERS. The annuity, for which a member is eligible, is limited to a minimum of \$300 per month and a maximum of 75 percent of the average compensation.

***Merit Annuity***

ERS members are eligible for merit annuity with a minimum of 30 years or more of credited service. The annuity for which the plan member is eligible is limited to a minimum of 65 percent and a maximum of 75 percent of the average compensation.

***Deferred Retirement Annuity***

A participating employee who ceases to be an employee of the Municipality after having accumulated a minimum of ten years of credited service qualifies for retirement benefits provided his/her contributions are left in ERS until reaching 58 years of age.

***Coordinated Plan***

On the coordinated plan, by the time the employee reaches 65 years old and begins to receive social security benefits, the pension benefits are reduced by the following:

- a. \$165 per month, if retired with 55 years of age and 30 years of credited service.
- b. \$110 per month, if retired with less than 55 years of age and 30 years of credited service.
- c. All other between \$82 and \$100 per month.
- d. Disability annuities under the coordinated plan are also adjusted at age 65 and in some cases can be reduced over \$165 per month.

***Non-Coordinated Plan***

On the non-coordinated plan the participating employee does not have any change on the pension benefits upon receiving social security benefits.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

***Reversionary Annuity***

An ERS member, upon retirement, could elect to receive a reduced retirement annuity giving one or more benefit payments to his/her dependents. The life annuity payments would start after the death of the retiree for an amount not less than \$240 per year or greater than the annuity payments being received by the retiree.

***Occupational Disability Annuity***

A participating employee, who as a direct result of the performance of his/her occupation is totally and permanently disabled is eligible for a disability annuity of 50 percent of the compensation received at the time of disability.

***Non-occupational Disability Annuity***

A participating employee, totally and permanently disabled for causes not related to his/her occupation and with no less than 10 years of credited service, is eligible for an annuity of 1.50 percent of the average compensation of the first 20 years of credited services, increased by 2 percent for every additional year of credited service in excess of 20 years.

***Death Benefits***

***Occupational:***

- a. **Surviving spouse** – annuity equal to 50 percent of the participating employee's salary at the date of the death.
- b. **Children** – \$10 per month for each child, minor or student, up to a maximum benefit per family of \$100.

***Non-occupational:***

**Beneficiary** – the contributions and interest accumulated as of the date of the death plus an amount equal to the annual compensation at the time of the death.

***Refunds***

A participating employee who ceases his/her employment with the Municipality without the right to a retirement annuity has the right to a refund of the contributions to ERS plus any interest earned thereon.

***b) Hybrid Defined Contribution Pension Plan***

On September 24, 1999, Public Act No. 305 was enacted to establish a defined contribution plan, known as System 2000, to cover employees joining ERS on or after January 1, 2000.

Employees that participated in the defined benefit plan as of December 31, 1999, had the opportunity to elect to either stay in the defined benefit plan or transfer to System 2000.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

Employees that joined the Municipality on or after January 1, 2000, were only allowed to become members of System 2000.

System 2000 is a hybrid defined contribution plan administered by the Retirement Systems Administration of the Commonwealth of Puerto Rico, also known as a cash balance plan. Under this new plan, there is a pool of plan assets, which is invested by the System, together with those of the cost-sharing multi-employer defined benefit plan. Neither the Commonwealth nor the Municipality guarantee benefits at retirement age. The annuity is based on a formula which assumes that each fiscal year the employee's contribution (with a minimum of 8.28 percent of the employee's salary up to a maximum of 10 percent) is invested as instructed by the employee in an account which either: (1) earns a fixed rate based on the two-year Constant Maturity Treasury Notes, (2) earns a rate equal to 75 percent of the return of the ERS' investment portfolio (net of management fees), or (3) earns a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability benefits are not granted under System 2000, rather are provided to those participants that voluntarily elect to participate in a private insurance long-term disability program. The employers' contributions (9.28 percent of the employee's salary) with respect to employees under System 2000 will continue and will be used to fund the cost-sharing multi-employer defined benefit plan.

System 2000 reduced the retirement age from 65 years to 60 for those employees who joined the current plan on or after January 1, 2000.

On April 4, 2013, the Governor of Puerto Rico, signed into law Act. No. 3 of 2013, which represents a comprehensive reform of the System. Act No. 3 became effective on July 1, 2013 and amended the provisions of the different benefit structures under the System, including, but not limited, to the following:

1. For active participants of the contributory defined benefit programs under Act. No. 447 of 1951 and Act. No. 1 of 1990, all retirement benefits accrued through June 30, 2013 were frozen, and thereafter, all future benefits will accrue under the defined contribution formula used for System 2000 participants, and will be paid at retirement through a lifetime annuity.
2. Increased the minimum pension for current retirees from \$400 to \$500 per month.
3. The retirement age for Act. No. 447 participants will be gradually increased from age 58 to age 61.
4. The retirement age for active System 2000 participants will be gradually increased from age 60 to 65.
5. Transitioning active participants under Act. No. 1 and Act. No. 447 to a defined contribution plan similar to System 2000.
6. Eliminated the "merit annuity" available to participants who joined the System prior to April 1, 1990.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

7. The retirement age for new employees was increased to age 67, except for new state and municipal police officers, firefighters and custody officers, which will be age 58.
8. The employee contribution rate was increased from 8.275% to 10%.
9. For System 2000 participants, the retirement benefits will no longer be paid as a lump sum distribution, instead, they will be paid through a lifetime annuity.
10. Eliminated or reduced various retirement benefits previously granted by special laws, including Christmas and summer bonuses. The Christmas bonus payable to current retirees was reduced from \$600 to \$200 and was eliminated for future retirees. The summer bonus was eliminated.
11. Disability benefits were eliminated and substituted for a mandatory disability insurance policy.
12. Survivor benefits were modified.

***Funding Policies***

The contribution requirement to ERS is established by law and is not actuarially determined. These contributions are as follows:

Municipality and other employers	12.28 percent of applicable payroll
Employees:	
Coordination plan:	7.00 percent of gross salary up to \$6,600 per year, plus 10.00 percent gross salary in excess of \$6,600.
Supplementation plan:	10.00 percent of gross salary. This is the only choice available to policemen, firemen and mayors

The contribution requirement to System 2000 is also established by law and is not actuarially determined. These contributions are as follows:

Municipality and other employers	9.28 percent of applicable payroll
Employees:	5.78 percent of gross salary up to \$6,600 per year, plus 8.28 percent of gross salary in excess of \$6,600.

During the fiscal years ended June 30, 2012, 2013 and 2014, the Municipality and the participating employees contributed at least 100 percent of the required contributions to ERS and System 2000. The combined actual contributions made by the Municipality and its

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

participating employees to ERS and System 2000 amounted to \$0.7 million, \$0.5 million and \$0.8 million for the fiscal years ended June 30, 2014, 2013 and 2012 respectively.

Readers can obtain information of the audited basic financial statements of ERS and System 2000 from the Retirement Systems Administration of the Commonwealth of Puerto Rico (the entity that administers ERS and System 2000) at PO Box 42003, Minillas Station, Santurce, Puerto Rico 00940-2003.

### 13. Commitments and Contingencies

The Municipality has reported outstanding encumbrances amounting to \$578,228 in the general fund at June 30, 2014. The Municipality intends to honor these encumbrances, which will continue to be liquidated under the current year's budget during a lapse period that extends into the subsequent fiscal year.

### 14. Fund Balances and Fund Net position

As of June 30 2014, fund balance is comprised of the following:

	<i>Governmental funds</i>					Total governmental funds	Las Flores Apartments - Proprietary fund
	General fund	Capital improvements bond fund	Legislative joint resolutions fund	Debt service fund	Other governmental funds		
<i>Spending:</i>							
<i>Assigned for:</i>							
Budgetary encumbrances - general government	\$ 578,228	-	-	-	-	\$ 578,228	\$ -
<i>Restricted for:</i>							
Capital projects - capital outlays related to the acquisition, construction and improvement of buildings, structures, infrastructure and other capital assets	-	2,837,839	1,314,200	-	2,059,057	6,211,096	-
Debt service of bonds and notes payable	-	-	-	2,711,737	-	2,711,737	-
Operation of state and federally funded programs public housing and welfare	-	-	-	-	152,503	152,503	1,438,235
<i>Unassigned</i>	1,228,842	-	-	-	-	1,228,842	-
Total fund balances	<u>\$ 1,807,070</u>	<u>2,837,839</u>	<u>1,314,200</u>	<u>2,711,737</u>	<u>2,211,560</u>	<u>\$ 10,882,406</u>	<u>\$ 1,438,235</u>

### 15. Prior-Period Adjustments and Restatements

During the current fiscal year the Municipality completed a physical inventory and valuation of its capital assets pursuant to the provisions of GASB Statement No. 34, *Basic Financial Statements— and Management's Discussion and Analysis—for State and Local Governments*, as amended. The physical inventory and valuation resulted in a prior-period adjustment of \$12,527,582 recorded at July 1, 2013 to reduce its capital assets used the governmental activities reported in the accompanying GWFS.

In addition, on July 1, 2013, the Municipality recorded a prior-period adjustment in its Section 8 Housing Choice Voucher fund, a non-major special revenue fund, to eliminate an overstatement in deferred inflows of resources pursuant to the provisions of GASB Statement No. 33, *Accounting and Financial Reporting for Non-exchange Transactions*. This adjustment was recorded in the accompanying GWFS and GFFS.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

The following table summarizes the effects of the aforementioned prior-period adjustments in the fund balances and net position of governmental activities as of July 1, 2013:

	<i>Governmental funds</i>					<i>Governmental</i>	
	<i>General fund</i>	<i>Capital improvements bond fund</i>	<i>Legislative joint resolutions funds</i>	<i>Debt service fund</i>	<i>Other governmental funds</i>	<i>Total governmental funds</i>	<i>Statement of net position</i>
Fund balances/net position (governmental activities) as of the beginning of the fiscal year, as previously reported	\$ 702,300	4,391,082	1,935,019	2,327,423	2,058,766	11,414,590	\$ 46,261,369
Add/(deduct):							
<i>Prior-period adjustments:</i>							
Capital assets, net of accumulated depreciation	-	-	-	-	-	-	(12,527,582)
Deferred inflows of resources	-	-	-	-	165,140	165,140	165,140
Total prior-period adjustments	-	-	-	-	165,140	165,140	(12,362,442)
Fund balances/net position (governmental activities) as of the beginning of the fiscal year, as restated	<u>\$ 702,300</u>	<u>4,391,082</u>	<u>1,935,019</u>	<u>2,327,423</u>	<u>2,223,906</u>	<u>11,579,730</u>	<u>\$ 33,898,927</u>

## 16. Subsequent Events

The Municipality evaluated subsequent events through February 20, 2015, date through which the financial statements were available to be issued. Following are the material subsequent events that the Municipality believes require disclosure.

On January 24, 2014, Act No.18, known as *Municipal Administration Fund Act* (Act No. 18), and Act No. 19, known as *Municipal Finance Corporation Act* (Act No. 19) were enacted to, among other things, amend Sections 4020.01, 4020.02 and 6080.14 of Act No. 1 of January 31, 2011, known as *Internal Revenue Code for a New Puerto Rico*.

Effective July 1, 2014, Act No. 18 reduced the statutory municipal sales and use tax rate from one point five percent (1.5%) to one point zero percent (1.0%) for all municipalities of Puerto Rico.

Simultaneously, Act No.19 created the *Municipal Finance Corporation* (MFC), a subsidiary of GDB, which is authorized to issue bonds and use other financing mechanisms to directly or indirectly pay or refinance all or part of the municipal long-term debt incurred that are payable from or backed by the municipal sales and use taxes effective July 1,2014.

In order to mitigate the effects of the reductions in the municipal sales and use tax rate referred to above, Act No. 18 established the mechanisms to protect the financial stability of the municipal governments of Puerto Rico by allowing the municipalities to continue receiving the economic benefits lost as a consequence of the reduction in the statutory municipal sales and use tax rate referred to above. For these purposes, effective July 1, 2014, Act No. 18 requires that an amount equal to zero point five percent (0.5%) of the state sales and use taxes collected by the Commonwealth of Puerto Rico be deposited in a special fund to be known as *Municipal Administration Fund* (MAF) in the name and for the benefit of each municipality of Puerto Rico.

Accordingly, commencing on July 1, 2014, the Commonwealth of Puerto Rico shall make advances from the collections arising from the zero point five percent (0.5%) of the state sales and use taxes to

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2014

the MAF of each municipality. The advances shall be made and distributed to the municipalities on a monthly basis as follows in accordance with Section 4050 of Act No. 1, as amended:

- i.* Forty percent (40%) of the amounts transferred shall be available to cover general operating expenses of the *General Fund* of each municipality.
- ii.* Forty percent (40%) of the of the amounts transferred shall be available and restricted in the MFC's redemption fund to guarantee the repayment of any municipal loan, bond, note, or other evidence of debt whose repayment source is the monies deposited therein under the custody of GDB.
- iii.* Twenty percent (20%) of the amounts transferred shall be available and restricted in the capital improvements bond fund to finance the acquisition, construction and improvement of major capital assets.

Pursuant to the provisions of Act No. 19, on July 1, 2014, the Municipality transferred to MFC all of its outstanding long-term debt payable and backed with the municipal sales and usage taxes, and the related accrued interests payable. The Municipality also transferred to MFC the outstanding balance of the cash held with fiscal agent and other which are restricted for the debt service of the debt transferred to MFC.

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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
 Budgetary Comparison Schedule – General Fund  
 June 30, 2014

	Budgeted amounts		Actual amounts (budgetary basis-Note 1)	Variance with final budget-over (under)
	Original	Final		
<b>Revenues:</b>				
Taxes:				
Property taxes	\$ 1,913,311	1,913,311	1,913,311	\$ -
Municipal license taxes	1,680,000	1,860,932	1,908,532	47,600
Construction excise taxes	200,000	206,475	368,109	161,634
Sales and use taxes	360,000	421,518	630,453	208,935
Total tax revenues	4,153,311	4,402,236	4,820,405	418,169
Intergovernmental grants and contributions	5,685,708	5,690,566	5,690,295	(271)
Interests on deposits	75,000	155,410	211,113	55,703
Charges for services	43,000	48,698	84,344	35,646
Miscellaneous revenues	51,000	174,110	278,927	104,817
Total revenues	10,008,019	10,471,020	11,085,084	614,064
<b>Expenditures:</b>				
Current:				
General government	3,326,081	3,582,881	3,519,330	(63,551)
Urban and economic development	4,057,232	4,274,233	4,029,078	(245,155)
Health and sanitation	367,838	367,838	359,359	(8,479)
Public safety	125,967	125,967	115,858	(10,109)
Public housing and welfare	523,079	503,079	410,043	(93,036)
Culture, recreation and education	893,701	902,901	834,888	(68,013)
Capital outlays	714,121	714,121	714,121	-
Total expenditures	10,008,019	10,471,020	9,982,677	(488,343)
Excess of revenues over expenditures	-	-	1,102,407	1,102,407
<b>Other financing sources (uses):</b>				
Transfers from other governmental funds	-	-	254,768	254,768
Transfers to other governmental funds	-	-	(63,599)	(63,599)
Total other financing sources, net	-	-	191,169	191,169
Excess of revenues and other financing sources over expenditures and other financing uses	\$ -	-	1,293,576	\$ 1,293,576

*The accompanying notes to the basic financial statements are an integral part of this statement.*

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Schedule of Expenditures of Federal Awards  
June 30, 2014

	<u>Federal CFDA Number</u>	<u>Pass-through Grantor's Number</u>	<u>Expenditures</u>
<b>U.S. Department of Housing and Urban Development</b>			
Section 8 Housing Assistance Payment	14.182	RQ46R000013	\$577,050
Section 8 Housing Choice Voucher	14.871	RQ-059	\$275,539
Pass-through of the State-Office of the Municipal Affairs Commissioners – Community Development Block Grant/State – Administered Small Cities	14.228	2014-004776	572,062
Emergency Solution Grant	14.231	2014-000162	16,482
Supportive Housing Program	14.235	PR0100B4N021100	2,625
			<hr/>
Total U.S. Department of Housing and Urban Development			1,443,758
			<hr/>
<b>U.S. Department of Justice</b>			
Justice Assistance Assistance Grant ARRA	16.738	2009-SU-B9-0053	70,000
			<hr/>
Total U.S. Department of Justice			70,000
			<hr/>
Total Federal Financial Assistance			\$ 1,513,758
			<hr/>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Notes to Schedule of Expenditures of Federal Awards  
June 30, 2014

**1. General**

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of Aibonito of the Commonwealth of Puerto Rico and is presented on the accrual basis of accounting. The Municipality of Aibonito reporting entity is defined in Note 1 to the Municipality's basic financial statements. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in our used in the preparation of the basic financial statements.

**2. Relationship to the Basic Financial Statements**

Revenues and expenditures of the federal awards are included in the Municipality's basic financial statements within the Capital Projects Fund, the Proprietary Fund and the Other Governmental Funds. The reconciliation between the expenditures in the basic financial statements and expenditures in the Schedule of Expenditures of Federal Awards is as follows:

Expenditures in the basic financial statements:

Capital Projects Fund	\$ 2,125,305
Other Governmental Funds	421,011
Proprietary Fund	<u>619,167</u>
	3,165,483
Less: Non-federal expenditures	<u>(1,651,725)</u>
 Total expenditures in the Schedule of Federal Awards	 <u>\$1,513,758</u>

**Report on Internal Control over Financial Reporting and on Compliance and other matters  
Based on an audit of Financial Statements performed in accordance with  
Government Auditing Standards  
June 30, 2014**

To the Honorable Mayor  
and the Municipal Legislature  
Municipality of Aibonito  
Aibonito, Puerto Rico

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, each major fund, and aggregate remaining fund information of the Municipality of Aibonito of the Commonwealth of Puerto Rico as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated February 20, 2015.

***Internal Control Over Financial Reporting***

In planning and performing our audit of the financial statements, we considered Municipality's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Municipality of Aibonito internal control. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be material weaknesses as items 14-01, 14-02 and 14-05.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

***Compliance and Other Matters***

As part of obtaining reasonable assurance about whether Municipality of Aibonito of the Commonwealth of Puerto Rico financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statements amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 14-03 thru 14-05.

***Municipality of Aibonito of the Commonwealth of Puerto Rico Response to Findings***

The Municipality of Aibonito of the Commonwealth of Puerto Rico response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. Municipality's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

***Purpose of this Report***

This report is intended solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Toa Alta, Puerto Rico  
February 20, 2015

Stamp No. O2708917  
was affixed to the  
original report.

A handwritten signature in black ink, appearing to be 'Benitez', is written over a circular stamp. To the right of the signature, the text 'CPA-PSC' is handwritten in black ink.

**Report on compliance for each major program and on  
Internal Control over compliance required by OMB Circular A-133  
June 30, 2014**

To the Honorable Mayor  
and the Municipal Legislature  
Municipality of Aibonito  
Aibonito, Puerto Rico

***Report Compliance on Compliance for Each Major Federal Program***

We have audited the Municipality of Aibonito of the Commonwealth of Puerto Rico (the Municipality) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have direct and material effect on each of the Municipality of Aibonito of the Commonwealth of Puerto Rico major federal programs for the year ended June 30, 2014. Municipality's major federal programs are identified in the Summary of Auditor's Results Section of the accompanying Schedule of Findings and Questioned Costs.

***Management's Responsibility***

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

***Auditor's Responsibility***

Our responsibility is to express an opinion on compliance or each of the Municipality of Aibonito of the Commonwealth of Puerto Rico major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Municipality's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of Municipality's compliance.

***Basis for Qualified Opinion on Pass-through State Office of the Municipal Affairs Commissioner – Community Development Block Grant/State – Administered Small Cities***

As described in the accompanying schedule of findings and questioned costs, the Municipality of Aibonito did not comply with requirements regarding CFDA 14.228 Community Development Block Grant/State – Administered Small Cities Program as described in finding numbers 14-03 for Cash Management, 14-04 for Earmarking requirement and 14-05 for Special Tests and Provisions (Housing Rehabilitation). Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

***Qualified Opinion on Pass-through State Office of the Municipal Affairs Commissioner – Community Development Block Grant/State – Administered Small Cities***

In our opinion, except for the noncompliance described in the Basis for Qualified Opinion paragraph, the Municipality of Aibonito complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on the Community Development Block Grant/State – Administered Small Cities Program for the year ended June 30, 2014.

***Unmodified Opinion on the Other Major Federal Program***

In our opinion, the Municipality of Aibonito of the Commonwealth of Puerto Rico, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its other major federal programs identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs for the year ended June 30, 2014.

***Report on Internal Control Over Compliance***

Management of Municipality of Aibonito of the Commonwealth of Puerto Rico is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Municipality's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weakness. However, material weaknesses may exist that have not been identified.

***Basis for Qualified Opinion on Pass-through State Office of the Municipal Affairs Commissioner – Community Development Block Grant/State – Administered Small Cities***

As described in the accompanying schedule of findings and questioned costs, the Municipality of Aibonito did not comply with requirements regarding CFDA Community Development Block Grant/State – Administered Small Cities Program as described in finding numbers 14-03 for Cash Management, 14-04 for Earmarking requirement and 14-05 for Special Tests and Provisions (Housing Rehabilitation). Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

***Qualified Opinion on Pass-through State Office of the Municipal Affairs Commissioner – Community Development Block Grant/State – Administered Small Cities***

In our opinion, except for the noncompliance described in the Basis for Qualified Opinion paragraph, the Municipality of Aibonito complied, in all material respects, the types of compliance requirements referred to above that could have a direct and material effect on the Community Development Block Grant/State – Administered Small Cities Program for the year ended June 30, 2014.

***Unmodified Opinion on the Other Major Federal Program***

In our opinion, the Municipality of Aibonito of the Commonwealth of Puerto Rico, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its other major federal programs identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs for the year ended June 30, 2014.

***Report on Internal Control Over Compliance***

Management of Municipality of Aibonito of the Commonwealth of Puerto Rico is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Municipality's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weakness. However, material weaknesses may exist that have not been identified.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

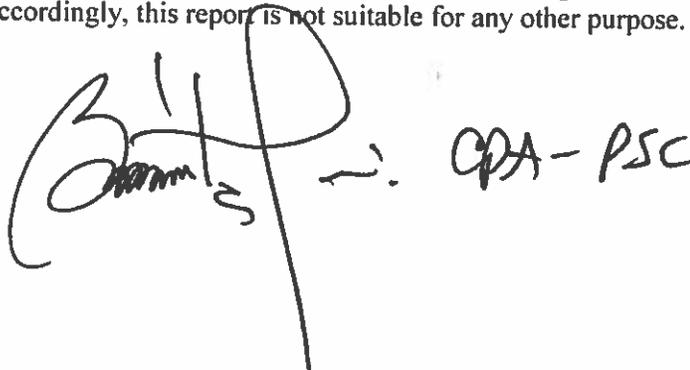
A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

The Municipality's response to the internal control over compliance findings identified in our audit is described in the accompanying schedule of findings and questioned costs. Municipality's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Toa Alta, Puerto Rico  
February 20, 2015

Stamp No. O2708918  
was affixed to the  
original report.

A handwritten signature in black ink, appearing to be 'Benitez', is written over a large, stylized 'S' or similar symbol. To the right of the signature, the text 'CPA-PSC' is written in a similar handwritten style.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Schedule of Findings and Questioned Costs  
June 30, 2014

**Section I - Summary of Auditors' Results**

**Financial Statements**

Type of auditor's report issued: Unqualified  
 Internal control over financial reporting:  
 Material weakness (es) identified?  yes  no  
 Significant deficiency (ies) identified  
 not considered to be material weakness?  yes  none reported  
 Noncompliance material to financial statements  yes  no  
 noted?

**Federal Awards**

Internal Control over major programs:  
 Material weakness (es) identified?  yes  no  
 Significant deficiency (ies) identified  
 not considered to be material weaknesses?  yes  none reported  
 Type of auditor's report issued on compliance  
 For major programs: Qualified  
 Any audit findings disclosed that are required  
 to be reported in accordance with  
 Circular A-133, Section .510(a)?  yes  no

Identification of major programs:

<u>CFDA Numbers</u>	<u>Name of Federal Program or Cluster</u>
14.182	Section 8 Housing Assistance Payments
14.228	Community Development Block Grant/State - Administered Small Cities Program

Dollar threshold used to distinguish  
 Between Type A and Type B programs: \$300,000

Auditee qualified as low-risk auditee?  yes  no

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Schedule of Findings and Questioned Costs  
June 30, 2014

**Section II - Financial Statement Findings**

The current year findings and questioned costs were discussed with the Municipality's management which generally concurred with our comments and recommendations. The Municipality of Aibonito will respond to the following findings through the issuance of a separate letter addressed to the Cognizant Agency.

**14-01 DEFICIENCIES IN THE UNIFORM ACCOUNTING SYSTEM AND OTHER ACCOUNTING RECORDS**

The Uniform Accounting System (UAS) and the accounting records currently used by the Municipality do not have the necessary capabilities, procedures, internal controls and records to ensure accurate financial reporting and to prepare the Municipality's basic financial statements and federal programs' reports in conformity with Accounting Principles Generally Accepted in the United States of America for State and Local Governments (GAAP). The UAS is a system promulgated by the Office of the Commissioner of Municipal Affairs of Puerto Rico (OCAM, by its Spanish acronyms), a governmental entity created by law to provide technical assistance to the municipalities of Puerto Rico in several administrative and fiscal matters.

The Municipality's UAS mostly provides for the recording of revenue collections, disbursements and other limited transactions. In addition, the accounting records are not fully integrated, and a double entry system is not generally followed. Accounting records are maintained on the cash basis and budgetary accounting bases (two accounting bases that differ significantly from GAAP) and do not comply with Statement No. 34 of the Governmental Accounting Standards Board (GASB 34), as amended.

The following specific additional conditions were noted in relation to the UAS of the Municipality:

- Accounting transactions are currently accounted for simultaneously through manual and computerized accounting systems for which no reconciliation procedures are made among them, including the accounting records currently used by federal programs which are not reconciled with the UAS. The balance sheet accounts in the UAS are not reconciled and adjusted to conform them to the Municipality's audited basic financial statements.
- The UAS does not have the capabilities of: (1) recording and processing all types of capital asset transactions, principally the accounting of depreciation and amortization expense, (2) recording and processing all transactions related to revenues susceptible to accrual (accounts receivable) and, (3) recording and processing transactions related to long-term debt, including bonds and notes payable, obligations under capital leases, reserves for federal cost disallowances, legal claims and judgments, compensated absences, etc.
- No adequate year-end closing procedures are made to account for all transactions affecting all funds.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Schedule of Findings and Questioned Costs  
June 30, 2014

- No adequate segregation is made between items representing actual accounts payable and those representing outstanding encumbrances. Accordingly, material amounts of unrecorded liabilities are generally recorded at fiscal year-end.
- The management of the federal programs administered by the Municipality maintains separate accounting records for each federal program, which are not reconciled with the UAS (the official accounting system of the Municipality).
- No adequate and complete accounting records are kept for inter-fund balances and transactions.
- The audit adjustments resulting from Single Audits are not completely posted in the UAS.

The basic financial statements of the Municipality must be prepared using the financial information obtained from various municipal departments and accounting records outside of the official UAS, and from information obtained from regulators and independent third parties. In addition, the Department of Finance does not maintain accounting records and working papers supporting the balances and disclosures reported in the basic financial statements, principally those related to government-wide financial reporting.

The Department of Finance does not maintain accounting records supporting the following procedures performed as part of the preparation of the basic financial statements of the Municipality:

- The conversion of accounting records from the cash basis of accounting to the modified accrual basis of accounting used by governmental funds;
- The conversion of governmental funds from the modified accrual basis to the accrual basis of accounting used by government-wide financial statements; and
- Working papers and analyses of significant balances reported in the basic financial statements, such as capital assets, accounts receivable (municipal licenses, grants and contributions, etc.), deferred revenues, accounts payable, and long-term obligations (for which the general practice is to rely upon the notifications received from the Government Development Bank for Puerto Rico, the Puerto Rico Treasury Department, the Federal Government and the Municipal Revenue Collection Center for the balance of its outstanding debt and the withholding for its debt service).

**CRITERIA:**

Article 8.010(b) of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that the Municipality must maintain its fund accounting in accordance with Accounting Principles Generally Accepted in the United States of America (GAAP), as promulgated by the Governmental Accounting Standards Board (GASB), the National Committee on Governmental Accounting (NCGA) and the Governmental Accounting, Auditing and Financial Reporting book (commonly known as Blue Book).

In addition, Article 8.010(c) of Law No. 81 states that uniform accounting system used by the Municipality must: (1) produce reliable reports and financial statements, (2) provide complete

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Schedule of Findings and Questioned Costs  
June 30, 2014

information about the results of operations of the Municipality, and (3) include the necessary internal controls to account all funds, capital assets and other assets of the Municipality.

Due to the conditions referred to above, the preparation of the Municipality's basic financial statements as of and for the fiscal year ended June 30, 2014 was more difficult and less efficient than would have been in ordinary circumstances. A significant amount of adjusting entries had to be made to the financial data and reports processed through the UAS in order to properly account for unrecorded transactions and to correct transactions recorded in the wrong accounting period. Since the accounts and other accounting records of the UAS are not designed to provide all the information necessary to prepare the Municipality's basic financial statements, the Municipality had to obtain and process financial data from several sources outside the UAS. These conditions represent material weaknesses in the Municipality's internal controls over financial reporting.

**CAUSE AND EFFECT:**

These conditions occurred because the accounting system currently used by the Municipality has not been updated in over 15 years and, accordingly, the Municipality has not implemented an accounting system in compliance with the current accounting model established by GASB Statement No. 34, as amended. The continued failure to have an adequate accounting system does not allow the Municipality to have timely and accurate financial information for its decision making process. In addition, financial reports prepared may have errors or omissions that will affect future financial decisions. Another effect is the use of inaccurate financial information as a base for the preparation of annual budgets, which, therefore, may result in budgetary compliance problems.

**RECOMMENDATION:**

We recommend the Municipality to explore different alternatives for the implementation of a new accounting system in compliance with all applicable federal and local laws and regulations. This process should include only accounting systems that will enable the Municipality to prepare its basic financial statements in a timely manner and in conformity with GAAP. The systems to be evaluated must provide the necessary financial information that will serve as the basis for the effective control of revenues, disbursements, assets and liabilities, and the reporting of such items in the Municipality's financial statements, including:

- The implementation of a double entry accounting system, the integration of all subsidiary ledgers and the reconciliation with the records maintained for federal funds;
- The preparation of periodic financial reports to be submitted to the Director of Finance, the Mayor, the Municipal Legislature and the federal grantors; and
- Adequate training to all accounting personnel to improve the understanding of the system and to promote operational efficiency

The Department of Finance must establish and document new accounting policies and procedures addressed to correct the non-compliance situations referred to above. Accounting policies and procedures shall be promulgated by an appropriate level of management to emphasize their importance and authority.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Schedule of Findings and Questioned Costs  
June 30, 2014

The documentation of such accounting policies and procedures shall be updated periodically according to a predetermined schedule.

**14-02 LACK OF MONITORING AND FRAUD PREVENTION ACTIVITIES**

As part of our evaluation of internal controls of the Municipality we noted that the Municipality have not designed, documented nor placed in operations specific internal controls and procedures designed to prevent fraud and certain types of misappropriation of assets, including certain situations that may lead to material inadequate financial reporting. In addition, does not keep verifiable records of the results of monitoring activities performed to avoid embezzlement and the identification and evaluation of the different types of fraud risk factors associated with the Municipality's core processes. The aforementioned conditions represent material weaknesses in the Municipality's internal controls over financial reporting.

**CRITERIA:**

Article 6.004 of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states the Municipality shall perform interventions, audits and monitoring activities over all municipal operations financed with public funds, including: (1) the acquisition, use and disposition of capital assets, (2) transactions and operations of all administrative units (municipal departments), and (3) all accounts, records, books, contracts, budgets and any other financial activities.

**CAUSE AND EFFECT:**

These conditions arose by the lack of effective controls and procedures for the evaluation of significant risk factors in all municipal areas, the lack of proper planning of continued monitoring activities, and the lack of proper allocation of human resources and time schedules to perform the activities required by law. These conditions, if not corrected, may increase the risk of instances of material unforeseen errors and irregularities that may not be detected in a timely manner by the current internal controls of the Municipality.

**RECOMMENDATION:**

We also recommend the Municipality to prepare a manual of policies and procedures specifically designed to prevent and detect fraud. The Municipality should also keep formal documentation of all fraud prevention and monitoring activities performed by management, including the identification and evaluation of all fraud risk factors. Fraud risk assessments should be reviewed periodically to consider changes in the operating policies of the Municipality and the control environment.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Schedule of Findings and Questioned Costs  
June 30, 2014

**Section III - Federal Award Findings and Questioned Costs**

<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
SBGP CFDA No. 14.228	<p><b>14-03 FEDERAL CASH MANAGEMENT SYSTEM</b></p> <p>Statement of Condition:</p> <p>The Municipality has not established effective cash management procedures. During our review of the drawdowns performed during the year, we noted the following deficiency:</p> <p>a. The Municipality performed 67 drawdown during the fiscal year 2013-2014 amounting to \$579,329. For 32 drawdowns amounting to \$265,909 or (48%) the disbursements related to the funds requested has a delay of 3 days or more between the funds receiving date and the disbursing date.</p> <p>Criteria:</p> <p>Federal regulations require that Grantee shall conform to the standards applicable to advances from Federal agencies. Amounts requested should be limited to the Programs immediate cash needs.</p> <p>OCAM grant agreement requires that “the Municipality should maintained requested funds from OCAM for a period no longer than three (3) days”.</p> <p>Cause and Effect:</p> <p>This condition arose because the Municipality has not implemented specific internal controls and procedures designed to minimize the time elapsed between the times when drawdowns are made and the subsequent time when disbursement of federal funds are carried out. This condition increases the risks of avoidable interest income and instances of idle cash balances in the program’s bank accounts.</p> <p>Recommendation:</p> <p>In accordance with Federal regulations, the Municipality should estimate drawdown’s of Federal funds as closely as possible to the actual disbursements. Also, the Municipality should established procedures to minimize</p>	NONE

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Schedule of Findings and Questioned Costs  
June 30, 2014

<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
SBGP 2009 AB CFDA No. 14.228	<p>the time elapsing between drawdowns and disbursements.</p> <p><b>14-04 EARMARKING REQUIREMENT</b></p> <p>Statement of Condition:</p> <p>As of June 30, 2014, the Municipality expended less than 70 percent of the funds received by the state, over a period of up to three years for activities that benefit low and moderate-income persons as required by the federal regulations. At June 30, 2014 the Municipality had expended \$114,129 or 33% of the funds awarded by the state amounting to \$350,000.</p> <p>Criteria:</p> <p>According to 24 CFR, 570.484 the State must certify that, in the aggregate, not less than 70 percent of the CDBG funds received by the state during a period specified by the state, not to exceed three years, will be used for activities that benefit persons of low and moderate income.</p> <p>Cause and Effect:</p> <p>This condition arose because the Municipality has not implemented specific internal controls and procedures designed to carry out effective monitoring activities over the management and use of federal awards, including, but not limited to, the enforcement of compliance with the 70 percent limitation referred to above and the training of municipal employees about this regulation.</p> <p>This condition, if not corrected, may increase the risk of avoidable instances of material non-compliances with the laws and regulations applicable to the Program.</p> <p>Recommendation:</p> <p>The Municipality should establish procedures to ascertain that comply with the earmarking requirement in accordance with 24 CFR sections 570.484. The Municipality should start the process to develop the</p>	NONE

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
Schedule of Findings and Questioned Costs  
June 30, 2014

SBGP  
CFDA No. 14.228

proposed projects as soon the grant agreements are received.

**14-05 INADEQUATE DOCUMENTATION OF PARTICIPANT FILES (REHABILITATION)**

Statement of Condition:

As part of our test to determine whether the grantee assure that the rehabilitation work is properly completed; we selected a sample of 15 participants, which represent 100% of the total population. We examined the participants file and the following documents were not present on file: \$20,758

a. Application form properly signed (OCAM-RMV-10-003)	10 Files	67%
b. Income verification (OCAM-RMV-10-002A)	2 Files	13%
c. Criteria for priority (OCAM-RMV-10-002B)	1 File	7%
d. Letter to owner notifying determination properly signed (OCAM-RMV-10-005).	13 Files	87%
e. Residence photo (before, during and completed)	9 Files	60%
f. Evidence of payments	15 Files	100%
g. Projected estimated cost of rehabilitation properly signed (OCAM-RMV-10-004)	13 Files	87%
h. Agreement of rehabilitation work signed by parties (OCAM-RMV-10-006)	11 Files	73%
i. Report on initial and partial inspections (OCAM-RMV-10-007)	15 Files	100%
j. Final inspection report (OCAM-RMV-10-008)	15 Files	100%
k. Agreement with owner properly signed by parties (OCAM-RMV-10-006 A, B o C)	11 Files	73%
l. Form OCAM-RMV-10-010	15 Files	100%
m. Expense register (OCAM-RMV-10-009)	15 Files	100%

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AIBONITO  
Schedule of Findings and Questioned Costs  
June 30, 2014

Criteria:

According to 24 CFR, 570.506 the grantee must assure that the work is properly completed. For each residential rehabilitation activity the following records are needed:

- a) Re-habilitation contract describing the deficiencies in each structure to be corrected.
- b) An inspection of the rehabilitation work upon completion to assure that it was carried out in accordance with contract specifications.

Also per OCAM Procedures Manual for Administration of Housing Rehabilitation established the required documentation to document the participant's file the moderate housing rehabilitation

Recommendation:

The Municipality must establish internal control procedures to ensure that all the required documentation by the OCAM Procedures Manual for the administration of the Housing Rehabilitation are present on the participant's file. Also, the Municipality must inspect the rehabilitation work upon completion to assure that it is carried out in accordance with the OCAM Procedures Manual for Administration of Housing Rehabilitation specifications.

Total Questioned Costs

\$20,758

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
 Summary schedule of prior years audit findings  
 Fiscal Year 2012-2013  
 June 30, 2014

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance and Internal Control Based on the Audit of the General Purpose Financial Statements for Performed in Accordance with Government Auditing Standards for the Fiscal Year ended June 30, 2013. Under the heading Corrective Action Taken there will be the following:

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2013-2014).
- NR - Not resolved yet. Finding repeated in fiscal year 2013-2014.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
13-01	Deficiencies in the uniform accounting system and other accounting records	NR
13-02	Deficiencies in accounting records of capital assets	FR
13-03	Lack of monitoring and fraud prevention activities	NR

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
 Summary schedule of prior years audit findings  
 Fiscal Year 2012-2013  
 June 30, 2014

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in accordance with OMB Circular A-133 for the Fiscal Year ended June 30, 2013. Under the heading Corrective Action Taken there will be the following:

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2013-2014).
- NR - Not resolved yet. Finding repeated in fiscal year 2013-2014.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
13-04	Federal Cash Management System	NR
13-05	Earmarking	NR

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
 Summary schedule of prior years audit findings  
 Fiscal Year 2011-2012  
 June 30, 2014

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance and Internal Control Based on the Audit of the General Purpose Financial Statements for Performed in Accordance with Government Auditing Standards for the Fiscal Year ended June 30, 2012. Under the heading Corrective Action Taken there will be the following:

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2013-2014).
- NR - Not resolved yet. Finding repeated in fiscal year 2013-2014.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
12-01	Deficiencies in the uniform accounting system and other accounting records	NR
12-02	Deficiencies in accounting records of capital assets	FR
12-03	Lack of monitoring and fraud prevention activities	NR

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AIBONITO**  
 Summary schedule of prior years audit findings  
 Fiscal Year 2011-2012  
 June 30, 2014

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in accordance with OMB Circular A-133 for the Fiscal Year ended June 30, 2012. Under the heading Corrective Action Taken there will be the following:

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2013-2014).
- NR - Not resolved yet. Finding repeated in fiscal year 2013-2014.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
12-04	Financial Reporting	FR
12-05	Cash Management System	NR
12-06	Davis-Bacon Act	FR
12-07	Earmarking	NR
12-08	Financial Reporting	FR